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STRENGTHENING THE ARMY-INDUSTRY
DIALOGUE ON DEFENSE COOPERATION
AND TRADE

Report AR910R1

November 1990

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REPORT DOCUMENTATION PAGE

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1. AGENCY USE ONLY (Leave Blank)		2. REPORT DATE Nov 90		3. REPORT TYPE AND DATES COVERED Final	
4. TITLE AND SUBTITLE Strengthening the Army-Industry Dialogue on Defense Cooperation and Trade				5. FUNDING NUMBERS MDA903-85-C-0139	
6. AUTHOR(S) Carlos M. Aquino					
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Logistics Management Institute 6400 Goldsboro Road Bethesda, MD 20817-5886				8. PERFORMING ORGANIZATION REPORT NUMBER LMI-AR910R1	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES) U.S. Army Materiel Command Attn: AMCICP-AD 5001 Eisenhower Avenue, Room 10N12 Alexandria, VA 22333-0001				10. SPONSORING/MONITORING AGENCY REPORT NUMBER	
11. SUPPLEMENTARY NOTES					
12a. DISTRIBUTION/AVAILABILITY STATEMENT A: Approved for public release; distribution unlimited				12b. DISTRIBUTION CODE	
<p>13. ABSTRACT (Maximum 200 words)</p> <p>The U.S. Army Materiel Command sponsored a conference in November 1988 to provide U.S. industry a platform to suggest ways in which the Army can modify policies and procedures to make U.S. companies more competitive participants in international markets. Conference working groups addressed industrial teaming, the defense industrial base, trade offsets, and technology security policy. These groups and a concluding panel of senior Army officials presented over 40 recommendations.</p> <p>The LMI report analyzes industry's views and presents proposals for their disposition. Among other things, LMI recommends that the "U.S. Industry Committee for Army International Programs," created by the American Defense Preparedness Association (ADPA) as a result of the conference, should coordinate with the Defense Policy Advisory Committee on Trade (DPACT). For its part, DPACT should call on the ADPA committee to provide an Army perspective and should encourage the other Services to establish similar forums. In addition, the Army should improve its contacts with appropriate OSD and other agency staffs in resolving DoD and U.S. Government-wide defense cooperation and trade issues, because it is in the Government's interest that contacts with industry present a consensus position. The Army should also improve internal staff coordination between its foreign military sales and international cooperative program communities.</p> <p>LMI's analyses and recommendations are divided into chapters dealing with Government-industry cooperation, defense exports and offsets, technology security and licensing, and a diverse set of other industry issues.</p>					
14. SUBJECT TERMS Defense trade; international cooperative programs; armaments cooperation; foreign military sales (FMS); direct commercial sales (DCS); offsets; memorandums of understanding (MOUs); technology security; export licensing; foreign availability; U.S. Government procurement policy; DoD acquisition streamlining.				15. NUMBER OF PAGES 111	
				16. PRICE CODE	
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	18. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UL		

Executive Summary

STRENGTHENING THE ARMY-INDUSTRY DIALOGUE ON DEFENSE COOPERATION AND TRADE

The U.S. Army and U.S. industry began a dialogue on defense trade and international armaments cooperation at a conference called by the Army Materiel Command (AMC) in November 1988. Such a dialogue is in the interest of both parties and should continue. However, it should support rather than duplicate the Government-industry dialogue conducted through the Defense Policy Advisory Committee on Trade (DPACT), which reports to the Secretary of Defense and the U.S. Trade Representative. That committee addresses many of the issues raised at the November 1988 conference. The Army should refer our recommendations on such issues, as well as others that fall beyond its authority, to OSD for DPACT consideration.

The "U.S. Industry Committee for Army International Programs," created by the American Defense Preparedness Association (ADPA) as a result of the conference, should pursue formal and informal coordination arrangements with DPACT. For its part, DPACT should call on the ADPA committee to provide a uniquely Army perspective on defense trade issues and should encourage the other Services to establish similar forums with industry. The Army should improve its working level contacts with appropriate OSD and other Federal agency staffs in resolving broad DoD and U.S. Government-wide issues. It is in the U.S. Government's interest that its contacts with industry in this area present a consensus position. The Army should also improve internal staff coordination between its foreign military sales (FMS) and international cooperative programs (ICP) communities.

In addition, we recommend that the Army take the following steps:

- Designate a senior Army official reporting directly to the Army Acquisition Executive to be responsible full-time for Army-wide international armaments cooperation.

- Improve coordination among overseas Army officials responsible for FMS, ICP, and foreign market analysis and their in-country Navy, Air Force, and OSD counterparts.
- Require U.S. Army negotiating teams for program memorandums of understanding (MOUs) to establish early contact with the Defense Technology Security Administration, the National Disclosure Policy Committee, and the State Department Office of Defense Trade Controls to identify and evaluate technology and information security requirements.
- Develop procedures to facilitate the exchange of classified solicitations and certain industry-developed technical data between U.S. industry and companies from our general and reciprocal procurement MOU partners
- Designate Army international cooperative program managers as the principal points of contact with and advocates for industry on the status of munitions export licenses associated with their programs. The U.S. Army Security Assistance Command should continue to perform this function for FMS and direct commercial sales licenses.
- Provide Advance Planning Briefings for Industry on foreign requirements, technologies, and cooperative opportunities, using the ADPA international committee.
- Regularly publish notification of Army ICP MOUs under development, together with invitations for comment from U.S. industry, in the *Commerce Business Daily*. For coproduction programs, however, include the single selected industry prime contractor or team as an advisor to the U.S. MOU negotiating delegation.
- Solicit a study from the ADPA international committee to evaluate proposals for improved Army support for field testing of industry equipment marketed overseas.
- Promote wide dissemination of Army Acquisition Executive Memorandum No. 88-8 on international cooperation in research, development, testing, evaluation, and acquisition.
- Identify shortfalls in executing the appropriate international cooperative opportunities provisions of Army Regulation (AR) 70-1 and AMC/Training and Doctrine Command Pamphlet 70-2, the basic Army guidance on systems acquisition.
- Publish the draft AR 70-41 and Department of the Army Pamphlet 70-XX on cooperative research and development programs and on identifying cooperative opportunities, respectively.

- Establish clear guidelines for staffing international program offices throughout AMC and for the professional development of the new DoD acquisition career series (No. 1101): "armaments cooperation specialist."
- Establish the "Basic Course in International Cooperative Programs," developed under AMC auspices, at an appropriate Army educational institution and evaluate additional training requirements in this field.



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CHAPTER 1

INTRODUCTION

PURPOSE

In November 1988, the Army Materiel Command (AMC) invited representatives of U.S. industry to attend a conference on "Improving U.S. Industry's Role in International Armaments Cooperation." The conference was designed to provide a platform for industry to suggest ways in which the Army can modify policies, procedures, and guidance to make U.S. companies more competitive participants in international teaming and export markets.

Conferees formed four working groups to focus on industrial teaming, the defense industrial base, trade offsets, and technology transfer security policy. The groups made 41 recommendations, and a concluding panel of senior Army officials generated three more. In January 1989, the Logistics Management Institute (LMI) published a report covering industry's recommendations, with supplementary background information and rationale but without critical comment.¹ The Army reviewed selected recommendations and solicited comments from OSD in limited areas. In this report, LMI presents its analysis of those conference recommendations and proposes some actions the Army should take.

BACKGROUND

The recommendation that received the widest acceptance by industry and Army conferees was the call for the establishment of a standing industry body to develop the conference recommendations further, to advise on and monitor their implementation, and to keep the Army leadership informed of additional industry concerns in the broad area of international defense trade. To meet that need, the conference established an interim committee of industry and Army representatives. That committee met several times in early 1989, with a staff member of LMI serving as advisor. The principal agenda item at those meetings was identification and

¹LMI Conference Report, *Improving U.S. Industry's Role in International Armaments Cooperation*. Alexandria, VA: January 1989. See Appendix A for recommendations of the conference report.

evaluation of options for a permanent institutional forum within which to continue the dialogue. After consideration of a range of options, including formal establishment of a Federal advisory committee (as defined by statute), the Army expressed preference for a "U.S. Industry Committee for Army International Programs" to be sponsored by an industry association. Such a committee was chartered by the American Defense Preparedness Association (ADPA) in November 1989 (see Appendix B). An important feature of that committee is that it provides for creation of subcommittees based in ADPA chapters collocated with AMC commodity-oriented major subordinate commands (MSCs). These subcommittees will address appropriate international issues relevant to the mission area of the particular commodity command and will report to the headquarters committee.

In early 1989, Headquarters (HQ), AMC, developed an action plan to pursue resolution or adoption of the industry recommendations. Approved by the Commanding General of AMC on 15 May for implementation, this plan correlated each recommendation with a responsible lead agency, an HQ AMC point of contact, a suggested action, and a completion date. The recommendations were circulated for disposition to appropriate offices in AMC; Headquarters, Department of the Army (HQDA); and OSD. As this process evolved, it became clear that the results might be limited to receiving written comments on the industry recommendations, rather than achieving changes in policy. A follow-up conference for providing a report on actions taken was postponed until the Army had time to review the comments received.

During DoD review of the action plan, three key concerns were expressed. First, many of the issues have been raised by industry in other forums for several years and would be resolved only over time because of their complexity and the need to secure a broad U.S. Government-wide consensus. Second, approval of the action plan by the Commanding General, AMC, implied to some in higher headquarters that AMC supported the industry recommendations in their entirety and was prepared to act favorably on them. Third, because many issues involve other elements of DoD and, indeed, other U.S. Government agencies, the action plan lacked sufficient coordination.

The AMC leadership then asked LMI to prepare this independent appraisal of the recommendations. Because some recommendations touch on the responsibilities of the U.S. Army Security Assistance Command as well as those of the Assistant Deputy for International Cooperative Programs, AMC leadership requested that the

LMI study address the Command broadly and directed that subsequent action and oversight for the Army-industry dialogue be managed jointly by both activities.

ORGANIZATION

Our treatment of the conference recommendations consolidates similar recommendations made by more than one working group and organizes them under headings slightly different from those assigned to the working groups. Chapter 2 deals with issues concerning cooperation between the Government and industry, many of which are within the Army's authority to resolve. Chapters 3 and 4 deal with long-standing issues of defense trade and offsets on the one hand and technology security and the export licensing process on the other; those require substantial interagency coordination to resolve. Chapter 5, the final chapter, contains some additional industry issues ranging from industrial competitiveness and procurement policy to the Army's organization for cooperative programs. In each chapter, we group related conference recommendations into two or three subordinate sections. In each section, we present industry's view of the issue followed by a discussion of its background and conclude with our recommendations and identification of the responsible official or agency to take action on the issue. Original texts of industry's recommendations are presented in Appendix A.

CHAPTER 2

INDUSTRY RECOMMENDATIONS FOR GOVERNMENT AND INDUSTRY COOPERATION ON INTERNATIONAL PROGRAMS

INTRODUCTION

The conference recommendations discussed in this chapter involve the kind and degree of cooperation industry would like to have with the Government in three broad categories. The first pertains to the Government's role in overseas marketing of defense goods, the second deals with information exchanges on foreign requirements and cooperative opportunities, and the third concerns industry's role in developing program memorandums of understanding (MOUs). Three industry working groups and the panel of senior Army officials made the recommendations discussed in this chapter. Recommendation numbers are those used in the January 1989 conference report. Following the discussion of the industry recommendations in the three categories, we present our own recommendations.

GOVERNMENT ROLE IN OVERSEAS MARKETING OF DEFENSE GOODS

U.S. Industry Issue

The Army should increase its activities in support of industry overseas marketing of defense products by allowing security assistance officers to play a more direct role in marketing support, expanding Army overseas field demonstrations of U.S. equipment through approved sales programs, and appointing export promotion advocates to serve in HQDA and OSD. (*Recommendations 2-1, 2-3, and 3-8*).

Discussion

American industry perceives that major U.S. trading partners and allies encourage their overseas defense, commercial, and MOU attachés to provide significantly more support to their industries' marketing activities than our Government provides to U.S. industry. It also claims that existing guidance on official support for American firms overseas is neither well understood nor well executed by U.S. embassy personnel. Finally, it would like to see Security Assistance

Organization/Office (SAO) and Office of Defense Cooperation (ODC) personnel adopt the more forthcoming and supportive posture toward U.S. industry that they see our commercial attachés offering nondefense U.S. firms. *Selling to the Allies, A Guide for U.S. Firms*, published jointly by DoD and the Department of Commerce, describes some of the support services available to U.S. industry from the Commerce Department's United States and Foreign Commercial Service (U.S.&FCS).

Before being posted overseas (e.g., whether to Military Assistance Advisory Groups, ODCs, or other forms of the generic SAO), security assistance officers must complete training at the Defense Institute for Security Assistance Management (DISAM). At DISAM, students are instructed on U.S. policy regarding support of industry's overseas marketing activities, most of which is documented in the *Security Assistance Management Manual (SAMM)*, DoD 5105.38-M. The training includes industry briefings on its concerns and unique perspective regarding Government support of industry's overseas marketing activities, as well as the foreign military sales (FMS) process in general. Industry presentations on the problems of promoting and managing U.S. defense exports are not, however, part of the training for U.S.&FCS officers or foreign service economic officers (State Department).

Current Guidance on SAO Support

In this subsection, we present a summary of U.S. policy affecting overseas marketing activities (see the SAMM Paragraphs 60002.D.3 and 60202-60203). Many of the following points were stated in a 10 July 1990 cable from the Deputy Secretary of State to the heads of all U.S. diplomatic posts. That cable reflected the State Department's desire for all U.S. mission personnel (e.g., SAO personnel, Foreign Service Officers, and U.S.&FCS officers) to support U.S. defense industry overseas on the basis of common guidance.

Industry must recognize its responsibilities in seeking assistance from SAOs. The Army recommends that, 30 days prior to initial overseas visits, industry representatives provide SAOs with information on the equipment and services they propose to offer for sale, export license(s) or applications (including restrictions and provisos), dates of planned in-country travel, nonproprietary information already provided or expected to be provided to the host country and its industry, and specific support requested (e.g., help in making appointments).

Security assistance officers are directed to extend the same support to U.S. firms marketing defense items as U.S.&FCS officers normally extend to U.S. firms selling commercial goods. That support includes providing general information, access to the embassy commercial library, and information about host country commercial law and customs regulations. However, because some nonpersonnel SAO costs are covered by administrative surcharges on the FMS price paid by recipient governments, some argue that providing SAO support to U.S. industry in direct commercial sales (DCS) cases conflicts (to a lesser extent since passage of the "Fair Pricing" initiative; see discussion in Chapter 3) with responsibilities to the FMS client government.

Nonsensitive and unclassified information on the host country defense establishment that can be released to U.S. industry includes data on the defense budget, the national defense decision-making and procurement processes, the kind of materiel currently required by the military, marketing efforts of third-country competitors, major in-country defense firms and their products, and U.S. financing assistance that may be available. In providing such information to U.S. industry, the SAO should draw on the expertise of country teams, including the commercial, economic, and political officers of the embassy.

When a visiting industrialist has been granted a license to release technical data, the SAO can provide additional support. That support includes assistance in arranging appointments with host government and industry officials, providing broad advice on marketing tactics, and informing the host government of the U.S. Government's agreement in principle supporting the sale (i.e., issuance of export licenses). However, requests by U.S. industry for special support to encourage or influence the decision of the host government for a particular purchase or requests for support on programs involving U.S. Government financing must be referred to the State Department for disposition.

American industrialists may conduct general overseas marketing activities without obtaining an export license if the information disclosed is in the public domain and if no specific proposal is made for the sale of significant military equipment (SME) valued at \$14 million or more. This latter provision is waived in the case of sales proposals to NATO countries or to Japan, Australia, or New Zealand, and in the case of other countries as long as the identical SME has been approved for permanent export to any country under a munitions license or FMS case. Proposals

for sales of \$14 million or more made to other countries require a 30-day advance written notice to the State Department. Special waivers are allowed only when no technical data are to be released. However, industry proposals for licensed manufacture or technical assistance in the production or assembly of SME, regardless of the dollar value, always require an export license, whether or not technical data are released.

The United States has concluded reciprocal agreements with 19 countries to waive "buy national" restrictions in defense procurement. In theory, those general and reciprocal (G&R) procurement MOUs enable U.S. industry to obtain advance procurement information on bid solicitations simultaneously with firms in the partner nation. That information should be provided by the in-country SAO to appropriate U.S. industry representatives, who should use it in keeping with the terms of the particular agreement to monitor the degree of market access. The security assistance officer and embassy commercial attaché are responsible for pursuing with the host government resolution of valid U.S. industry claims of noncompliance.

Currently, the Independent European Program Group (IEPG) is establishing procedures for the reciprocal exchange of request for proposals (RFP) and bid and proposal (B&P) information among its 13 members (i.e., NATO less Canada, Iceland, and the United States). Also, the United Kingdom and France reciprocally exchange such information, and during 1990 most of the remaining IEPG countries will do the same. The formats and frequency for release of the information will vary in each IEPG country, since some will engage commercial publishing companies in preparing bulletins while others will release information directly from their ministries of defense (MoDs). The IEPG Secretariat, operational since May 1989, has maintained information on points of contact within each MoD, and U.S. embassy personnel are working through that channel to acquire information concerning each IEPG country.

Other assistance that SAOs are obliged to provide U.S. industrialists includes support in making appointments with other officials in the U.S. embassy and with officials of the host government and its industry. The latter support is normally limited to identifying the appropriate officials to contact rather than actually making appointments. In some cases, security assistance officers will be asked to attend these meetings to provide an independent view of the extent to which the particular U.S. firm can satisfy the military requirements of the host government. Similarly,

the security assistance officer must be prepared to pursue follow-up inquiries from U.S. industry with the host government and should encourage visiting U.S. industrialists to debrief appropriate members of the embassy staff on the course of all contacts in-country. Beginning in February 1990, the Defense Security Assistance Agency (DSAA) instituted a program in which SAOs maintain (for host country government/industry use) a *Catalog of U.S. Defense Articles and Services* composed of individual submissions, in a prescribed format, provided by U.S. industry. DSAA Memorandum I-00550/90, dated 20 February 1990, provides more information on this program.

Because of the broad supplier base in the United States, SAOs must maintain strict neutrality when more than one U.S. competitor is pursuing a foreign sale. In such cases, the SAO may present to the host government the virtues of acquiring a U.S. system in principle. The SAO may also inform the interested companies of the in-country marketing presence of their competitors and the degree of SAO support furnished, without providing proprietary information. When only one U.S. supplier is competing, the SAO may endorse its product insofar as it satisfies the host government's requirement. However, all parties concerned should be aware that the Foreign Assistance Act [specifically 22 U.S.C. 2321i(f)] constrains the support that U.S. embassy officials may provide. That act states that

the President shall continue to instruct United States diplomatic and military personnel in the United States missions abroad that they should not encourage, promote, or influence the purchase by any foreign country of United States-made military equipment, unless they are specifically instructed to do so by an appropriate official of the executive branch.

American industry must acknowledge the limits that SAOs face given the unique features of the U.S. defense establishment and Government-industry relations. While most of our defense trading partners have a single supplier for particular major end items, the United States enjoys competitive sources for most nonmajor end items and for major developmental systems that have not yet been fielded. Furthermore, many partner nations own significant segments of their country's defense industrial base and therefore support their industry in foreign marketing as a matter of official state policy.

In addition to representing competitors fairly, SAOs should support U.S. firms marketing less expensive or less advanced systems in the same way that they support firms marketing major systems. While major sales programs may receive support

from several elements within an embassy, smaller items should also receive official support if they warrant it. Similarly, SAOs must evenhandedly provide the same support to firms selling U.S. nonstandard equipment that they provide for those marketing items currently in the U.S. inventory. Furthermore, the SAO should inform the host government that U.S. nonstandard equipment can be purchased through FMS channels.

Department of Defense policy traditionally has shown no preference for FMS over DCS as a vehicle for U.S. defense exports. Consistent with this, SAOs will not normally provide price and availability data to host governments on a given sale so they can compare FMS and DCS. In general, the SAO should counsel caution to the host government in comparing FMS and DCS data on delivery schedules, equipment modifications, spare parts, and training packages for particular sales programs. One source that should be used to help clarify the differing merits of FMS and DCS to host governments is the DSAA publication, *A Comparison of Direct Commercial Sales and Foreign Military Sales for the Acquisition of U.S. Defense Articles and Services* (15 October 1985).

In addition to these considerations in SAO support to industry, another recent development of interest is the 1986 assignment or redesignation of 46 "armaments cooperation specialist" billets at SAOs in Europe and the Far East. Establishment of this new career specialty (civilian personnel series 1101) reflects the growing importance of cooperative research, development, and production with our principal allies. Those armaments cooperation professionals augment the traditional security assistance, military training, and logistics support functions carried out by security assistance officers and are responsible for the defense cooperation in armaments (DCA) mission within the SAO.

Equipment Demonstrations Overseas

The U.S. Army agrees in principle with industry's interest in Army-sponsored field demonstrations of U.S. equipment in support of approved sales programs. Such demonstrations are normally conducted through the lease of U.S. Army-owned equipment either to the prospective customer or to U.S. industry. Industry can secure approval for temporary export of equipment for demonstration purposes through the munitions export process (using State Department License DSP-73). Furthermore, improving procedures relating to overseas demonstrations in support

of sales promotions is one of the security assistance issues the Army Deputy Chief of Staff (Logistics) was directed to review by the Army Chief of Staff in June 1990. This review had not been completed as of this writing.

American industry has long felt at a competitive disadvantage with respect to its major foreign competitors whose governments are said to support overseas field demonstrations more actively. Industry points out that, since the U.S. Government currently assumes the cost of U.S. equipment demonstrations performed in CONUS for foreign government officials, industry has limited opportunity to use them for sales presentation. Industry states that to make more effective use of such demonstrations it has been willing to assume their direct costs, including a share of Government personnel costs, the cost of consumables expended, transport, and handling expenses. Moreover, U.S. industry argues that its competitive disadvantage against foreign equipment is worsened through Foreign Comparative Testing and similar programs, in which foreign weapons receive a stamp of approval, whether or not they are acquired, while U.S. products not designed to meet U.S. requirements are not even tested and certified.

American industry will frequently develop and market export versions of U.S. defense equipment either when the Government is unwilling to approve the release of the most sophisticated items or when the potential customer cannot afford leading-edge technology and has sought the U.S. Government's support in testing and certifying export versions of equipment items. In many cases, the U.S. Government has little incentive to test and certify the export version because it may not be able to recover associated costs if a sale is not made, and because it may not have an overseas logistics system to support such nonstandard items. However, when an existing customer requests modifications to a fielded U.S. system that would make it an export version, the U.S. Government may be reimbursed for test and certification as well as for the cost of establishing a modified logistics support system. In the absence of these conditions, U.S. industry is left to negotiate case-by-case test, certification, and logistics support arrangements with the U.S. Government for approved export items and to assume all associated costs.

High-Level Political Advocacy

The creation in 1987 of the position of DoD Trade and Defense Cooperation Advocate by the Deputy Secretary of Defense helped provide high-level political

advocacy for promotion of exports and armaments cooperation. That political position, which was designed to provide a focal point for advocacy before Congress and in the inter-agency process, has remained vacant, however, since the end of the Reagan Administration. Early in 1987, the Deputy Secretary of Defense directed each of the Service Secretaries to establish a "full-time senior official . . . (to) be responsible for international armaments cooperation. This senior official and staff should be physically positioned within the office of and report directly to (the Service) Acquisition Executive." Each of the Service Secretaries has now designated a one- or two-star officer to have at least part-time responsibility for international programs.

LMI Recommendations

We recommend that the Army take the following actions with respect to the conference recommendations:

- The Secretary of the Army should designate a full-time, senior official, reporting directly to the Army Acquisition Executive, to be responsible for international armaments cooperation, consistent with the 1987 Deputy Secretary of Defense directive.
- The Commanding General, AMC, should improve coordination mechanisms between the DCA officials within SAOs and their Service counterparts in-country. Several countries with significant DCA activities also have U.S. Army Research, Development, and Standardization Groups (USARDSGs) (the United Kingdom, France, Germany, Canada, Australia, and possibly Japan soon) or Science and Technology Centers (STCs) [Germany (responsible for Europe) and Japan (responsible for the Far East)]. The other Services have similar arrangements in these and other countries. Better procedures must be developed for information exchange and division of labor among such Service activities and the appropriate SAOs, perhaps using as a model the May 1987 "Interface Agreement" between the chiefs of the SAO and the USARDSG in Bonn.
- The Commanding General, AMC, should request that the "U.S. Industry Committee for Army International Programs," recently established under ADPA auspices, conduct a study aimed at proposing procedures for industry to finance Army-managed test and certification for nonstandard, export items of equipment.

We further recommend that the Under Secretary of Defense (Acquisition) [USD(A)] and the Director, DSAA, take the following actions:

- Ensure that in countries with which the United States has G&R procurement MOUs, SAOs are responsible for distributing information on

foreign government RFPs and B&P procedures to U.S. industry. Government-to-government exchanges of such information should become routine within NATO through the Conference of National Armaments Directors (CNAD). Similar exchanges should be developed on a bilateral basis with the remaining countries with which the United States has G&R procurement MOUs or similar agreements (i.e., Sweden, Israel, Egypt, Australia, and Switzerland). The United States should secure agreement with those countries to publish RFP and B&P data in the *Commerce Business Daily (CBD)* or *Federal Register* to alleviate the SAOs' problems of determining which U.S. companies to notify. The joint DoD/Department of Commerce document, *Selling to the Allies. A Guide to U.S. Firms*, contains general B&P and contracting procedure information on each G&R procurement partner.

- Revise the *SAMM* to make DCA officials accountable to the SAO chief in-country on a daily basis, while receiving policy guidance from the USD(A) in Washington. Currently, DCA officials answer to too many supervisors, including one or more of the following: the SAO chief (a DSAA employee); the chief of the Defense Attaché Office (DAO) [a Defense Intelligence Agency (DIA) employee] (for certain countries such as the United Kingdom and Israel); the U.S. Defense Representative, who in some cases is different from both the SAO and DAO chiefs; the Ambassador (a State Department official); the Commander-in-Chief of the appropriate Unified Command (who normally delegates this responsibility to the J-4); the Director, DSAA; and, the USD(A). The DCA official should be required to coordinate with the other persons mentioned only on a "for information" basis.

INFORMATION EXCHANGES ON U.S. AND FOREIGN REQUIREMENTS

U.S. Industry Issue

The U.S. Army should expand existing mechanisms and develop new ones for providing information to U.S. industry on foreign technologies, hardware requirements, potential sales, and cooperative opportunities. At the same time, the Army should adjust its major systems acquisition procedures to consider foreign requirements and technologies in its acquisition strategies. One instrument that could help provide information exchange would be a standing Army-industry committee on international defense trade and cooperation issues. Such a committee should be responsible for clarifying specific recommendations raised at the November 1988 AMC conference, following up to ensure implementation of appropriate recommendations, communicating progress regularly to all

constituencies, and identifying and addressing additional industry concerns as they develop. (*Recommendations 3-4, 3-7, 3-15, 3-17, and 6-3*).

Discussion

U.S. and Foreign Industry Access to U.S. Requirements

Army materiel requirements documents (MRDs) [e.g., Operational and Organizational Plans and Required Operational Capabilities (ROC)] are circulated for industry comment during their initial staffing as prescribed in Appendix J of the joint AMC/U.S. Army Training and Doctrine Command (TRADOC) Pamphlet 70-2. The *CBD* is used to advertise the availability of a draft MRD for industry comment. Within 14 days of the *CBD* announcement, the AMC MSC Technical Industrial Liaison Office (TILO) assembles the list of interested companies, both domestic and foreign; confirms clearances, need-to-know, and storage facilities (for classified MRDs); and releases the MRD. Releasability of classified MRDs to foreign industry is often delayed by TRADOC- and AMC-required disclosure reviews. Written industry comments must be received by the appropriate TILO within 45 days (75 for ROCs). The TILO cannot accept (unsolicited) comments on draft MRDs from firms that failed to respond to the initial *CBD* announcement. All industry comments are then considered in a closed session of a TRADOC-chaired Joint Working Group, which makes final determination on incorporating appropriate industry comments into the MRD.

U.S. Access to Foreign Requirements and Technologies

The principal means by which U.S. Army personnel obtain access to foreign requirements information is either through embassy/MOU attaché channels or, in the case of NATO, through the new Conventional Armaments Planning System (CAPS); however, CAPS information is not currently made available to U.S. industry. In the case of foreign technology, work is underway on a prototype Foreign Market Analysis System (FMAS) for the Army that will access on-line information sources such as DIALOG, the European Community Host Organization (ECHO), and the Office of Naval Research ASSETS. FMAS planners hope, in the future, to be able to incorporate information on NATO-nation requirements and acquisition plans generated by CAPS. In addition, the U.S. Army Laboratory Command (LABCOM) has established an international research technology branch to serve as a focal point for Army laboratory international programs; coordinate AMC participation in

international cooperative technology base activities; and develop and maintain an international technology database to support the integration of technical information from foreign sources into the AMC research, development, test, and evaluation (RDT&E) program.

None of these information bases, however, contains provisions for industry access; neither FMAS nor CAPS data are currently releasable to contractor personnel. The Office of the Deputy Under Secretary of Defense for International Programs [ODUSD(IP)] has conducted periodic Advance Planning Briefings for Industry (APBI) on the status of the CAPS trial, but these sessions have not presented detailed programmatic information. The ODUSD(IP) officials point out that information generated during the first CAPS trial (1988 to 1989) has not been of sufficient quality to satisfy industry's advance planning needs. A more promising avenue for providing CAPS information to allied industries is through the NATO Industrial Advisory Group (NIAG), but this approach may not be pursued until the second CAPS cycle is completed, sometime in 1991. In the meantime, U.S. industry can, and most likely already does, access foreign technology and materiel information by directly subscribing to DIALOG and other databases.

Developing Systems with Foreign Requirements in Mind

Our allied MoDs develop weapon systems for much smaller domestic markets. To achieve economies of volume production, they frequently tailor their acquisition strategies to satisfy foreign military requirements and plan production schedules to coincide with expected export demands. The United States has traditionally followed a different approach, with U.S. industry oriented principally toward meeting the needs of its large and stable customer -- the U.S. Government -- first. Moreover, Government program managers are evaluated on the basis of their ability to meet the schedule, cost, and performance needs of their Service alone and do not address modifications for cooperative programs or foreign sales until the production base is in danger of becoming cold.

Because of a recent growth in competition from foreign industry for the DoD market as well as an overall slowdown in defense spending worldwide, U.S. industry is beginning to adapt its product development and marketing strategy to satisfy a broader customer base. The U.S. Army and DoD generally can reinforce this trend by modifying existing guidance to program managers to ensure that foreign sales and

cooperative opportunities are considered earlier in the acquisition cycle. An example of such guidance is a Department of the Army (DA) pamphlet (70-XX), currently in draft, on the preparation of Cooperative Opportunities Documents (CODs). Army program manager charters have frequently made reference to the importance of NATO and allied rationalization, standardization, and interoperability (RSI) through armaments cooperation and also foreign sales, but major system acquisition reviews have until recently tended to gloss over such considerations.

Establishment of a Permanent Army-Industry Forum

One of the most broadly embraced recommendations emerging from the November 1988 AMC conference was a call for establishment of a permanent Army-industry forum to continue the dialogue. The principal tasks for such a forum would be to encourage industry to clarify recommendations made at the conference, to provide a channel for reviewing the status of implementation of particular recommendations, to identify additional areas of concern, and to ensure that appropriate Government and industry constituencies are informed of the forum's activities.

Shortly after the conference, HQ AMC convened several meetings of working group leaders from the conference to discuss a more permanent Army-industry forum. In searching for a more permanent forum, this *ad hoc* committee reviewed three alternative approaches: establishment of a committee or subcommittee of an existing body within the terms of the Federal Advisory Committee Act; conduct of *ad hoc* meetings with industry under formal programs such as the APBI Program or the Army Scientific and Technical Information Program; or establishment of a subordinate body within an existing trade association or under a quasi-governmental/industrial organization such as the NIAG or the National Academy of Public Administration. During the deliberations of the *ad hoc* committee, ADPA proposed the establishment of, first, a Washington-based industry committee to relate to HQDA and HQ AMC and, second, commodity-oriented subcommittees based in ADPA chapters to relate to AMC's MSCs. The ADPA proposal was accepted by the Army.

The proposed committee and subcommittees would operate through the convening of quarterly meetings, with Army participation on an as-needed basis at the request of the committee chairperson to the Commanding General, AMC, or the

respective MSC. Industry members would be selected from the ranks of ADPA's U.S. industrial membership, each with fixed tenure. Subjects discussed would be those mutually agreed upon but could include all international issues relevant to the particular command. Those issues include cooperative RDT&E, production, procurement, logistics support, FMS, foreign resource dependency, and foreign direct investment in, and ownership of, U.S. defense industrial capacity. In-depth studies could be commissioned by the committee chairpersons on a case-by-case basis to be performed by the industry members using the resources of their companies and of ADPA.

Terms of reference (TOR) were approved by the president of ADPA in November 1989 (see Appendix B), and the committee was renamed the U.S. Industry Committee for Army International Programs to make clear that it is not an official Army committee. A chairperson was appointed from among the industry membership. A letter from the Commanding General, AMC, to the MSC commanders and the ADPA president endorsed the establishment of subordinate committees under ADPA chapters serving the constituencies of the AMC commodity-oriented MSCs.

LMI Recommendations

We recommend that the Commanding General, AMC, take the following actions with respect to the conference's recommendations on Army-industry information exchange on requirements:

- Develop procedures for effective coordination between the Defense Policy Advisory Committee on Trade (DPACT) and the newly established ADPA committee. The DPACT is a Federal Advisory Committee established to provide industry views to the Secretary of Defense and the United States Trade Representative on defense trade issues. It is composed of chief executive officers and other senior officials of 30 to 35 leading U.S. defense manufacturers. Many of the issues raised at the November 1988 Army-industry conference and found in this report are addressed by the DPACT. Since the ultimate mission of the two bodies is the same, a degree of synergy and cooperation should be developed between them. As a minimum, coordination should include periodic status briefings by the ADPA committee to meetings of the DPACT.
- Request the newly established ADPA U.S. Industry Committee for Army International Programs to address the question of industry access to the FMAS, Army-provided CAPS inputs, and related databases.

INDUSTRY ROLE IN DEVELOPING PROGRAM MEMORANDUMS OF UNDERSTANDING

U.S. Industry Issue

The U.S. Army should institutionalize advance consultation with industry on international cooperative programs, particularly by involving industry early in developing program MOUs. Industry involvement is essential if industry is to have timely information for advance planning of long lead-time technology development and capital investment and time to identify foreign teaming partners and define subcontractor relationships. In view of the importance of industry-to-industry teaming in international cooperative programs, the Army should ensure that program management structures for such programs include a significant role for industry representation, particularly since industry possesses the bulk of technology, manufacturing, and marketing expertise. (*Recommendations 2-5, 2-6, 2-7, 3-3, and 4-6*).

Discussion

Consultation with Industry on MOUs

The opportunity for industry to comment on draft cooperative program MOUs is essential, since the Government may be committing industry to management, licensing, technology transfer, work sharing, production, and other arrangements through such agreements. Advance consultation with industry during the MOU development process, however, is not always as easy as it seems. One concern is the Government's need to avoid favoritism while seeking industry's views. The DoD regulations and public statutes on the role of competition in source selection forbid giving one contractor an unfair advantage over another. Most of our MOU partners feel less constrained in this area because of the small size of their prime contracting community, government ownership of some defense industry, and their less regulated source-selection procedures. In the past, some nations have brought their industry representatives to the MOU negotiating table and have otherwise sought extensive industry involvement early in the MOU development process. American companies involved in such programs have reported obtaining draft MOU copies from their foreign industrial counterparts before receiving them from DoD. Because of our inability to offer U.S. industry the same role, the United States has in the past insisted on the exclusion of all industry personnel from MOU discussions. Recently,

however, DoD has determined the degree of industry involvement in program MOUs on a case-by-case basis.

One way to consult with industry without giving unfair advantage to any contractor is to issue requests for information (RFIs) through the *CBD* or the *Federal Register*. RFIs would notify industry of a DoD Component's interest in negotiating a program MOU with an allied or friendly nation and provide a synopsis of the draft MOU for comment. The synopsis could include the draft statement of work and provisions on work sharing, intellectual property rights, and project management organization. Comments received from industry would be subject to release under the Freedom of Information Act.

Government-to-government MOUs tend to be negotiated relatively late in the program conception process. Therefore, it is essential that industry receive as much information on the military requirements and acquisition strategy as is appropriate at the time that the Army establishes its intent to negotiate an MOU or concludes a Statement of Intent (SOI) agreement. Some approaches designed to provide broad information include APBI and informal "debriefings" with industry by the U.S. Mission to NATO following semiannual meetings of the CNAD. These approaches, however, present the problem of determining which firms to invite or indeed whether to rely on a third party, such as an industry trade association, to make that determination. All participating governments should agree early in the development of the MOU on the arrangements for advance notification and involvement of their industries prior to source selection.

Program Management Office Organization

With respect to the industrial program management structure, most MOUs do not prescribe specific organizational forms, allowing the selected contracting sources from the participants to establish the teaming arrangements they deem appropriate. When the MOU defines the industrial program management structure, some mechanism must be established to solicit comment from potential contracting sources on draft MOU language concerning this issue. Government international program management structures should be well integrated with their industry counterparts if not physically collocated. That integration requires that lead nations and their prime contractors in international programs exercise strong management of such programs to ensure that the authority to apply resources and responsibility are not

separated. Generally, it also means that management authority and responsibility for program decisions should not be diluted by assigning a day-to-day oversight role to a multinational committee.

LMI Recommendations

We recommend the following actions with respect to the conference recommendations on developing MOUs:

- The Commanding General, AMC, should use the newly established ADPA committee as the principal vehicle for U.S. Army APBIs providing the full range of releasable information on proposed international programs.
- The Assistant Secretary of the Army (Research, Development and Acquisition) should ensure that RFIs are routinely published in the *CBD* or *Federal Register* to solicit early industry comment on international cooperative programs for which the Army is developing an MOU or has signed an SOI.
- In the case of coproduction MOUs involving a developed U.S. system with a single prime contractor or team, the Army Deputy Chief of Staff (Logistics) should ask the prime contractor or team to support the U.S. negotiating delegation in an advisory capacity. For such MOUs, inclusion of the already-selected U.S. source poses no problems in choosing which U.S. firm to include.

CHAPTER 3

INDUSTRY RECOMMENDATIONS ON DEFENSE EXPORTS AND OFFSETS

INTRODUCTION

Industry recommendations discussed in this chapter deal with defense trade and offsets and are grouped into two categories. The first involves specific U.S. Government practices affecting the assessment, recovery, and/or allowability of costs associated with FMS and DCS. The second deals with broad policy matters of trade and offsets. The recommendations emerged from three working groups. Recommendation numbers are those used in the January 1989 conference report. Again, following the discussion of conference recommendations, we present our own recommendations.

GOVERNMENT PRACTICES AFFECTING COSTS OF FOREIGN MILITARY SALES AND DIRECT COMMERCIAL SALES

U.S. Industry Issue

The U.S. Government should reduce or waive the assessment of charges designed to recoup sunk R&D and other nonrecurring costs in FMS programs, particularly in cases in which such costs have already been fully recovered. These charges have become, in effect, export taxes that reduce the cost competitiveness of U.S.-manufactured items on international markets. Additionally, the U.S. Government should permit U.S. industry to recover, as an allowable cost, its expenses incurred in overseas marketing, including the cost of administering offsets. Recognition of the allowability of these costs would bring the U.S. practice into line with that of most of our defense trading partners. (*Recommendations 2-4, 3-13, and 4-3*).

Discussion

Industry has identified two fundamentally different issues that affect the costs of FMS and DCS and place U.S. industry at a disadvantage in competition with foreign defense industry. One is the recovery by the U.S. Government of certain costs

associated with both FMS and DCS. The second is the recovery by industry of its overseas marketing costs for FMS and DCS.

Government Recovery of Defense Export Costs

Government charges for defense exports above and beyond the contractor's price fall into one of two broad categories: surcharges generally added to the price of all items of equipment sold routinely through the FMS program, and special charges assessed on particular FMS cases to recover the costs of managing them intensively. Surcharges of principal interest to industry include recoupment of nonrecurring costs (NRC) of RDT&E and production; administrative costs (normally assessed at 3 percent of the value of the item being sold); and asset use and rental of Government-owned plant, equipment, and facilities by industry in connection with FMS. Other surcharges cover such services as contract administration (associated with quality assurance, inspection, and contract auditing) and accessorial costs (e.g., shipping and handling). The Arms Export Control Act (AECA), however, was amended in 1985 to allow for the reciprocal waiver of surcharges in the case of "cooperative projects" [22 U.S.C. 2767(e)].

Special charges against particular FMS cover, *inter alia*, incremental costs of supplies and materiel, travel, and personnel (at least one man-year equivalent) that exceed costs routinely incurred in the overall administration of the FMS program; i.e., they are charges that can clearly be identified with a single FMS program.

In general, the U.S. Government seeks to recover those costs because of long-standing statutory (i.e., AECA) requirements that appropriated funds not be used to finance or support defense exports. Industry has not disputed this principle when special charges are concerned. However, it has raised opposition to the Government imposition of three surcharges: the NRC recoupment surcharge, the 3 percent administrative surcharge, and the asset use surcharges. Some industry concerns have been alleviated by the "Fair Pricing" initiative discussed below; however, the following discussion is presented as background.

NRC Recoupment Surcharge. The most controversial surcharge, which is added to the price of FMS and DCS cases, is the NRC recoupment surcharge. It is intended to recover the FMS order's share of the prorated RDT&E and production base investment costs already paid by the Government. Determination of the prorated foreign share of NRC is inexact, since it is based on expected U.S. and foreign sales

orders, and the Government has no process for retroactively modifying the surcharge as sales orders change.

Industry spokesmen contend that the RDT&E and production base investment costs are sunk and would have been incurred even in the absence of FMS. Thus they believe this surcharge is in effect an "economic rent" rather than a fee designed to recover costs incurred as a result of the FMS. Moreover, industry argues that the NRC recoupment surcharge may reduce orders for U.S. goods because of the price elasticity of demand (not demonstrated conclusively) and may thus limit collateral benefits the United States would otherwise enjoy from greater FMS. These benefits include lower unit costs for procured items arising from production efficiencies, and maintenance of a warm production base for critical items in the U.S. inventory.

Industry has specifically opposed the imposition of NRC recoupment surcharges on DCS cases and on non-Major Defense Equipment (MDE) items for FMS on the grounds that the AECA [specifically, 22 U.S.C. 2761(e)(1)(B)] requires such surcharges only on MDE FMS cases. The DSAA counters that the provisions of DoD Directive (DoDD) 2140.2 calling for broader NRC recovery are inspired by the traditional U.S. Government neutrality between the two broad sales options (FMS and DCS) and, therefore, that imposing surcharges on FMS and not on DCS would bias foreign governments toward DCS. The DSAA makes a similar argument in opposing price discrimination between MDE and non-MDE sales. However, the Director, DSAA, recently issued a policy letter to U.S. industry and to affected foreign governments announcing that DoD will no longer assess NRC recoupment surcharges on DCS cases for which the sale is financed 90 percent or more by so-called "forgiven" FMS credit funds. The next revision of DoDD 2140.2 will reflect this change.

The Government has examined alternatives for remedying the perception that the NRC recoupment surcharge represents an arbitrary tax on exports that is particularly difficult to assess and enforce in the case of DCS. One alternative is to waive the surcharge altogether in cases in which industry can demonstrate direct foreign competition for its proposed sale. In fact, the SAMM (Paragraph 130104.B.1) provides for case-by-case waiver or reduction of these surcharges for sales that can demonstrably enhance standardization with NATO nations, Japan, Australia, and New Zealand. The country or international organization involved is responsible for

requesting such waivers, and the Secretary of Defense (delegating to the Director, DSAA) is empowered to grant such waivers.

Another alternative is to improve accounting and administrative procedures to allow for retroactive rebates and re-collections in cases in which actual foreign sales orders vary from figures used to estimate original NRC recoupment surcharges. Finally, the capriciousness of the levy could be reduced for MDE by imposing a flat surcharge on the value of sales items, as is done for non-MDE by most of our principal allies (e.g., the United Kingdom, 7.5 percent; Germany, 5 percent; and France, 2 percent).

Administrative Surcharge. For the most part, the 3 percent administrative surcharge covers the operating cost of FMS administrative agencies such as DSAA and, in the case of the Army, the U.S. Army Security Assistance Command (USASAC). However, industry claims that the Services normally directly bill the personnel costs, no matter how small, of many military or civilian activities associated with FMS administration, rather than only those of the full-time staff (e.g., USASAC) and thereby charge paying FMS customers more than the law intends. Moreover, the costs of preparing price and availability (P&A) estimates and letters of offer and acceptance (LOAs) when a foreign government does not exercise its option to buy from the United States are part of the cost pool covered by the administrative surcharge levied on paying customers. That surcharge cannot be tailored to reflect the fact that, over time, it may be more costly to do FMS business with certain countries than with others. On the other hand, personnel costs for preparing an LOA for an FMS case that is executed are directly billed to that particular case and are detailed in the LOA.

The 3 percent administrative surcharge is also assessed against Government-furnished equipment (GFE) packages in DCS cases on the grounds that they are, in effect, FMS components of the sale. Industry has long objected to this practice, claiming that it discriminates in favor of FMS by unnecessarily raising the price of the DCS item and that the Government provides none of the sales support services (e.g., LOA preparation and contract administration) and assumes none of the financial risk associated with the sale.

Asset Use Surcharge. Industry also contends that the Government has effectively imposed asset use surcharges on DCS cases by charging tooling rental

when industry uses Government-owned plant and production equipment or facilities. Industry points out that the AECA [prior to the "Fair Pricing Initiative" (discussed below)] requires asset use surcharges only on FMS cases. DoD acknowledges the validity of that assertion but counters that whenever Government assets are used to produce goods sold commercially, "tooling rental charges" must be collected from an administrative/policy standpoint. Otherwise, DoD would appear to subsidize commercial products by allowing the rent-free use of Government-owned assets.

While the SAMM (Paragraph 130104.B.2) and DoD FAR (Federal Acquisition Regulation) Supplement (DFARS) paragraph 245.405(e) allow for selected waivers of asset use and tooling rental surcharges (e.g., to promote NATO standardization), DoD has invoked its traditional neutrality between FMS and DCS to oppose waiving such surcharges when such waiver would result in a price preference for one of the two defense export channels. The only other substantial exception is in cases in which a foreign government or international organization has funded the "acquisition of specific production and research property" wherein rents will not be charged for use of those specific assets [DFARS 245.405(d)].

"Fair Pricing" Initiative. In principle, DoD has recently supported reducing or waiving FMS surcharges designed to recover NRC and some administrative costs. The Reagan Administration submitted the "Fair Pricing" initiative to Congress for inclusion in the FY89 foreign assistance appropriations bill. In its submitted form, that proposed initiative would have reduced collection of some NRC recoupment surcharges [waiving them for cases paid for by the grant military assistance program (MAP) and by forgiven FMS credits], waived contract administration service surcharges on equipment currently being purchased by DoD, waived all asset-use surcharges, eliminated military pay and allowances surcharges in cases financed by forgiven FMS credits, and billed all security assistance officer costs to DoD rather than to the FMS program. Despite strong initial support in the Senate, the measure ultimately passed only as a limited waiver of specified administrative and nonrecurring surcharges for Israeli and Egyptian F-16 purchases.

The Bush Administration resubmitted the original conception of the "Fair Pricing" initiative for consideration in the FY90 foreign assistance legislation, and Congress addressed it in the defense authorization and appropriation bills. Section 9104 of the FY90 DoD appropriations act and Section 1606 of the FY90-91 DoD authorization act amended the AECA and the Foreign Assistance Act of 1961 in the

following manner: first, NRC recoupment surcharges will no longer be assessed on grant-funded (e.g., MAP) and/or forgiven credit cases; second, overseas FMS administration costs associated with military salaries and civilian and military retirement and other benefits will no longer be recovered through FMS surcharges; and third, asset use surcharges are dropped for all cases.

Industry Recovery of Foreign Selling Costs

DCS vs. FMS. The issue of industry's recovery of the costs of selling in foreign countries is a simple one insofar as DCS is concerned. Foreign selling costs can be factored into the price of the item to the extent that the purchasing foreign government is willing to pay. Competitive U.S. firms marketing items through DCS channels hope over time to establish a sufficiently profitable business base overseas to cover the cost of sales failures as well as successes. One potential risk that U.S. firms face in foreign marketing is the possibility that a foreign government may elect to procure the item through FMS channels, and DoD may then open the procurement to competitive solicitations from several sources. In that case, the U.S. firms that had expended foreign marketing resources might suffer a price disadvantage in comparison to their competitors.

Recovery of Offset Administration Costs. DFARS 225.7304(c)(1)(iii) provides that administrative costs associated with implementation of offset arrangements under FMS contracts, cash or U.S. Government-financed, are allowable.

Foreign Selling Agent Fee. Current regulations (see DFARS 225.7305) limit the allowable fee or commissions paid to foreign selling agents in a given FMS case to \$50,000. That restriction affects particularly those smaller firms and firms without extensive foreign selling experience that rely heavily on foreign selling agents because they cannot afford the cost of maintaining a foreign presence for the multiyear level of effort required by most FMS cases. Most of U.S. industry's principal foreign competitors enjoy some competitive advantage because they operate under more permissive arrangements for recovering foreign selling agent fees.

Foreign Selling Costs. DFARS 225.7304(c) and 231.205-38(c) describe foreign selling costs that can be billed as allowable to DoD contracts awarded in support of FMS cases. In general, allowable costs are similar to those for an equivalent sale for DoD end use. Prior to 1977, U.S. defense contractors were able to charge all selling costs — both foreign and domestic — to their total defense business overhead

applicable commonly to DoD contracts for foreign and domestic end uses. Regulations were changed in 1977, and codified by statute in 1985, to disallow the charging of foreign selling costs to DoD contracts for U.S. requirements; the changed regulations allowed contractors to charge foreign selling costs only to FMS contracts. Industry believes that that provision increases the price of FMS while FMS unit prices are already carrying unnecessary or unfair surcharges. Industry argues further that smaller firms suffer disproportionately from this arrangement because they are likely to have fewer FMS contracts against which to charge their foreign selling costs.

As a result of these and other concerns, the FY89 National Defense Authorization Act added Section 2324(f)(5) to Title 10, U.S.C., establishing a 3-year trial period (ending 30 September 1991) during which a U.S. contractor would be able to charge against all DoD contracts its foreign selling costs up to \$2.5 million and above \$2.5 million up to a ceiling not to exceed 110 percent of the previous fiscal year's allowable foreign selling costs. The only other constraints are that they be "reasonable," "allocable," and "not unallowable" under other DoD contract regulations. The DFARS was also modified to broaden existing provisions for foreign selling cost reimbursement to include recovery of costs of demonstrations and trade show exhibitions, including salaries, transportation, and meeting room rental.

LMI Recommendations

In response to the conference recommendations on Government practices affecting the recovery of certain costs of FMS and DCS, we recommend that:

- The Secretary of Defense request Congress to give him authority to waive NRC recoupment surcharges when direct foreign competition can be demonstrated; he should, in turn, delegate that authority to the Director, DSAA.
- The Director, DSAA, reduce significantly the 3 percent administrative surcharge assessed against GFE incorporated in DCS items. The U.S. Government provides no additional service and assumes no significant risk in these limited cases and, by imposing this surcharge, may be biasing the customer away from DCS as an option.
- The Director, DSAA, allow reimbursement for foreign selling agent fees to grow as a decreasing function of the value of the sale, rather than be set at a flat maximum of \$50,000. For example, the Director, DSAA, could allow 5 percent fees for sales valued up to \$1 million and set the allowable

percentage for sales between \$1 million and \$100 million to a rate that declines linearly with sale size to a flat 0.5 percent for sales greater than \$100 million. That approach would somewhat correlate the allowable cost of foreign selling agent sales support to the value of the sale while recognizing that "learning curves" and "economies of scale" tend to reduce the marginal cost of increasingly larger sales.

- The Director, DSAA, request Congress to task the General Accounting Office to evaluate the impact of the past three foreign selling cost regulatory/statutory regimes on the U.S. industrial base, relative prices and selling cost "subsidies" at home and abroad, and relative foreign market penetration and competitiveness of U.S. industry. These three regimes are: pre-1977, U.S. contractors permitted to charge selling costs for marketing at home and abroad commonly to all DoD contracts (both FMS and DoD end-user); 1977 through FY88, U.S. contractors required to charge foreign and domestic selling costs separately to FMS and DoD end-user contracts; and FY89 through FY91, return to the pre-1977 regime except that cost recovery is limited by dollar and percentage ceilings.

NATIONAL DEFENSE TRADE AND OFFSETS POLICY

U.S. Industry Issue

The Government should seek limits on trade offsets through the mechanism of multilateral negotiations or in the context of renegotiation of G&R procurement MOUs, rather than through unilateral or legislated limitation. Otherwise, the U.S. Government should limit the practice of accepting defense trade offsets in the following ways: access to defense markets and policies on offsets should be enforced reciprocally and equivalently with respect to our G&R procurement MOU partners; in the case of our G&R procurement MOU partners, offsets should be limited to those directly associated with the item being sold (i.e., to "direct offsets" in the form of industrial "compensation" or participation in production); and for all countries, offsets should be prohibited on sales financed by FMS credits, forgiven loans, or other U.S. Government-backed grant programs. Finally, the U.S. Government should refrain from imposing protectionist "buy American" restrictions on its own procurements, particularly when they conflict with the terms of our existing G&R procurement MOUs. (*Recommendations 3-6, 3-11, 3-12, 4-1, 4-2, 4-4, 4-5, and 4-7*).

Discussion

Motivations for and Effects of Offsets

Offsets are contractual arrangements involving considerations other than the normal ones of price and availability made in pursuit of the export sale of a defense good or service. Offsets are a form of non-price, or countertrade, arrangement. A particular characteristic of offsets is that they are commitments on the part of the seller — either offered by him or demanded by the buyer — to provide something of value to the buyer other than the product sold or advantages of price or availability associated with it. They represent industrial and commercial compensation for the purchase.

Offsets can be categorized as direct or indirect. Direct offsets relate to the item being sold and may, for example, take the form of coproduction by the buyer of the item itself or of its components. If the buying government focuses on components, it may require the seller to buy back a portion of this component production for incorporation into the seller's end-item production. Such "buybacks" are also generally regarded as a form of direct offset even though they go beyond the buyer's procurement. Indirect offsets are not related to the item being sold and may, for example, take the form of a commitment by the seller of the item to buy back other goods or services from the item's buyer — hence the term "countertrade."

Direct offsets in the form of participation in production of the item being bought are often sought by importing governments in order to acquire manufacturing technology needed to develop the importer's industrial capability. This participation in production may result in inefficient overcapacity, but it may also create low-cost suppliers of componentry and reduce future production costs for the exporter. The creation of low-cost offshore suppliers will, however, erode the position of competing domestic suppliers. On balance, the U.S. Government should have no objection to direct offsets that create efficient offshore suppliers as long as the domestic suppliers they replace are not essential for non-cost reasons such as protection against the risk of losing offshore suppliers due to foreign political decisions.

By maintaining employment and promoting exports, offsets can be useful to the purchasing government in helping to convince domestic constituencies to accept a decision to rely on offshore sources for defense equipment. In the case of developing nations with shortages of hard currency and without the industrial or technological

wherewithal to participate directly in acquiring a sophisticated defense system, indirect offset arrangements may provide the only affordable means of meeting defense needs. While they thus ease the political burden of defense imports for buying governments, they sometimes also help, however, to sustain a U.S. production source for at least part of an end item that may be required by U.S. forces in wartime.

Indirect offsets are generally more problematic than direct offsets. They are challenged principally because of their trade distorting effects. Depending on the deals struck, they can amount to barter arrangements not regulated by price mechanisms. As such, they tend to reduce the efficiency of markets by shifting employment in the exporting economy from business activities for which there is a comparative advantage to those for which there is not. As a result, while the effect of indirect offsets on net employment is uncertain, they clearly tend to replace jobs in one sector with those in another. Some of these effects are mitigated by the use of more sophisticated forms of indirect offsets such as joint venture arrangements between the buyer and the seller and foreign direct investment by the seller in the buying nation's industry.

Industry Replies to Claims of Offsets' Negative Effects

Many U.S. industrialists counter that there is no conclusive evidence linking trade offsets to loss of work on the part of U.S. subcontractors, arguing instead that unfavorable exchange rates, noncompetitive prices, or poor product quality may instead be the causes. In any case, industry argues that, from a national economic standpoint, refusal to accept offsets will result in a greater net loss of jobs (i.e., "better some share in the value of a sale than 100 percent of no sale"). Furthermore, since the United States has the world's largest economy and thus the largest market for foreign goods imported through (indirect) offsets, the universal demand for offsets may actually give U.S. exporters an advantage in relation to their competitors from smaller nations.

Regarding loss of competitiveness due to transfer of production process know-how in fulfillment of offsets, similar questions arise. For example, defense trade offsets constitute only a small portion of technology transfer by U.S. businesses, many of which participate in foreign direct investment projects in lower-cost developing countries. In addition, U.S. industry's protectiveness toward sensitive or proprietary production technology often results in only relatively obsolete technology

being transferred in fulfillment of offset obligations. After all, private industry should be trusted to pursue its best interests, with corporate decision makers consciously weighing short-term sales benefits against long-term competitiveness in deciding whether to export items tied to offset demands. In general, however, U.S. industry would rather not risk creating foreign competition through direct offset arrangements where no comparable local industrial capacity had previously existed. Thus, indirect offsets, though often more inefficient, present less commercial risk from the standpoint of the individual firm.

Regarding the question of their impact on jobs, direct offsets involved in the export of sophisticated defense systems with many foreign components and subassemblies may in some cases reflect the principle of international specialization through comparative advantage. Even though mandated by governments rather than by market forces, foreign supply of certain components may represent a crude reflection of comparative advantage in that the most advanced economies are responsible for developing and integrating a sophisticated system composed of less sophisticated components. In any case, many observers argue that the U.S. Government pursues direct offsets as aggressively as any of its defense trading partners by insisting — for wartime mobilization reasons, to be sure — on a domestic (licensed) production source for all major foreign end-item procurements.

Regarding distortions of the world trading system, U.S. industry argues that defense indirect offsets are only a small portion of trade practices that have similarly distorting effects. These include government-subsidized export financing and a wide range of import tariff and non-tariff barriers.

U.S. Government Policy on Offsets

Ever since the issuance of a landmark 4 May 1978 Deputy Secretary of Defense memorandum, DoD policy has been to refrain from committing the U.S. Government to achieve or guarantee the achievement of offsets. The policy resulted from "inherent difficulties in negotiating and implementing compensatory coproduction and offset agreements," as well as from the economic inefficiencies associated with offsets. Exceptions to this policy "may be made only when there is no feasible alternative to ensure successful completion of transactions considered to be of significant importance to U.S. national security interests." If an exception must be

made, the responsibility for agreeing to and executing offsets "rests with the U.S. firms directly benefiting from the sale."

The official DoD "hands-off offsets" policy is being challenged by Congress, which is increasingly concerned with what it perceives to be erosion of the U.S. defense industrial base, particularly at the subcontractor tiers. Since 1985, the Defense Production Act, under review in late 1990 for reauthorization, has contained a provision (50 U.S.C. 2099) requiring the Office of Management and Budget (OMB) to prepare annual reports to Congress on the impact of offsets on the U.S. industrial base and international export competitiveness. Beginning with the first report in December 1985, these OMB reports have broadly concluded that offsets have had a smaller negative impact on the defense sector of the U.S. economy than would have resulted from loss of sales because of rejection of offset demands.

Not satisfied with these findings, Congress expressed additional offset concerns to the Administration in the FY89 DoD authorization act (see section 825). Among other things, this act requires the President to establish a comprehensive policy on offsets and to enter into negotiations with major defense trading partners, within 2 years, to limit "the adverse effects that such (offset) arrangements have on the defense industrial bases" of each country. In addition, through the Omnibus Trade and Competitiveness Act of 1988, Congress authorized the President to negotiate the reduction of non-tariff trade distorting measures, including defense trade offsets. Finally, an amendment to the reauthorization (S.1379) of the Defense Production Act introduced by Senator Alan Dixon (D-IL) would require U.S. industry to report on all offers of, acceptances of, or demands for defense trade offsets valued at \$5 million or greater. Currently, industry is required to report on offset offers/acceptances of \$50 million or more [10 U.S.C. 2505(c)]. The Dixon Bill would also transfer responsibility for preparing the annual OMB offsets report to the Commerce Department.

As a result of congressional pressure, reinforced in the Senate Armed Services Committee report on the FY90-91 DoD authorization act, the National Security Council (NSC) staff has chaired an interagency group since late 1989 to review U.S. Government offset policy. One element of this review was a Commerce Department request for industry comment posted in the *Federal Register* late in 1989. Comments received from industry were nearly unanimous in opposing increased U.S. Government intervention on offsets beyond the terms of the May 1978 Deputy

Secretary of Defense memorandum. On 16 April 1990, the White House released *The President's Policy on Offsets in Military Exports* in response to the FY89 DoD authorization act provisions. For the most part, this document reinforces and restates policies of past administrations (e.g., the May 1978 memorandum). However, it added a directive that the Secretary of Defense, in coordination with the Secretary of State, lead an interagency team to consult with other nations "with a view to limiting the adverse effects of offsets in defense procurement." DoD has demonstrated its sensitivity to political pressures by modifying its long-standing "hands-off" approach to offset regulation in the case of the Korean Fighter Program (KFP). In this case, Secretary of Defense Cheney secured the Seoul Government's agreement to limit offsets to 30 percent of the value of the proposed aircraft sale. Seoul interprets this 30 percent figure as limiting indirect offsets only, while the United States maintains that it refers to all offsets.

Negotiations on Offsets

American industry argues that regulating offsets is a problem requiring agreement by all of the United States' major defense trading partners. Unilateral action by the U.S. Government to restrict offsets would undoubtedly result in overseas defense business going to those nations and companies willing to offer competitive offset and industrial compensation arrangements. Some industrialists have suggested that the offset issue, and indeed broader defense trade regulatory issues such as tariff and non-tariff barriers, could best be addressed in one of three multilateral trade negotiating forums: the Multilateral Trade Negotiations (MTN) of the General Agreement on Tariffs and Trade (GATT), the United Nations Conference on Trade and Development (UNCTAD), or the Organization for Economic Cooperation and Development (OECD).

While the GATT has traditionally excluded consideration of defense issues, the increasing incidence of so-called "dual-use" technology trade, as well as the growing salience of issues such as intellectual property rights and foreign direct investment within the current Uruguay MTN Round, may argue for reconsideration of this separation. However, given the advanced state and crowded agenda of the Uruguay Round, such issues could be addressed only in a subsequent Round. The GATT and UNCTAD include many developing countries with whom eliminating offset demands would be politically difficult, in view of their unfavorable trade balances in the defense area, and would have only little payoff in terms of relieving the competition

faced by U.S. subcontractors. Thus, under present circumstances the OECD, even though it is not normally concerned with defense- and security-related issues, would be preferred to either the MTN or UNCTAD as a forum for considering the offset issue in that its membership includes all of the advanced industrial democracies and many of the newly industrialized countries (except South Korea).

The Department of Defense is currently addressing statutory requirements for offsets negotiations in the context of reauthorizing its G&R procurement MOUs, many of which came up for renewal in 1988 and 1989. In preparing for talks on these MOUs, DoD has opposed establishing preferences for any particular form of offset regime (e.g., direct versus indirect offsets). Since nearly all of our G&R procurement MOU partners have advanced industrial economies and in most cases greater reliance on defense exports than the United States, DoD has some leverage to press for significant limitations on the use of offsets within the terms of these renegotiated agreements. Unlike many developing countries that purchase U.S. weapon systems or receive U.S. aid, our principal G&R procurement MOU partners have favorable trade balances and well-developed defense industrial bases, making it difficult for them to justify demanding offsets.

The U.S. Government might consider pressing for offset limitations in renegotiating G&R procurement MOUs with countries that have the least justification for offsets, such as the United Kingdom or France. The United States could press for insertion of a clause in the new agreements stating that demands for offsets (particularly indirect) are inconsistent with the spirit of the MOUs. Successfully pursuing this approach with our largest G&R procurement MOU trading partners first would establish a precedent for later negotiations with countries more dependent on indirect offsets.

Another variant might be for the United States to host a conference of its G&R procurement MOU partners to address the offset problem in such a way as to apply equal performance standards to all countries. The United States would need to identify sanctions in advance for those partners continuing to make (indirect) offset demands. These could include restricting access to the U.S. defense market or applying reciprocal and equivalent offset demands.

U.S. Government Financing of Offsets

Finally, the use of offsets in defense exports financed through U.S. Government-forgiven loans or grant aid has been identified by industry as a particularly troublesome practice. This view, however, reflects a misunderstanding of U.S. law and DoD regulation. In general, the U.S. Government has prohibited the use of grant aid or credit financing for FMS purchases conditioned on offset provisions. The AECA specifically prohibits the use of direct FMS credits or guaranteed loans to finance licensed or coproduction of U.S.-origin defense equipment outside the United States [22 U.S.C. 2791(b)]. Similarly, the use of any monies authorized under the AECA, including direct FMS credits and guaranteed loans, may not be used for procurement outside the United States [22 U.S.C. 2791(c)]. Exceptions can be made to either prohibition of the AECA only upon certification by the Administration to Congress that offshore production or procurement will not have an adverse impact on the U.S. industrial base or economy.

Buy American Restrictions

Industry has noted that Congress has selectively sought to check erosion of the U.S. defense industrial base by the use of "buy American" restrictions on DoD procurement. A report on the impact of such restrictions was mandated by the FY89 DoD authorization act and delivered to Congress by the Secretary of Defense in July 1989. That report noted that buy American restrictions have been incorporated in annual DoD authorization and appropriations acts in growing number and scope during the 1980s.

The report concluded that the process by which Congress decides to establish particular buy American restrictions is heavily political and does not always account for the full range of military, industrial, economic, and alliance effects that can result. It noted that the Secretary of Defense already has ample authority to restrict procurement to the relevant domestic sources when a production base is in jeopardy and has delegated to the Military Departments and Defense Logistics Agency authority to restrict procurements of individual end items. It recommends, therefore, that Congress encourage, strengthen, and monitor DoD's use of this existing authority and phase out the *ad hoc* legislated buy American restrictions enacted in previous authorization and appropriations acts.

Moving in the opposite direction, however, is an amendment to the reauthorization of the Defense Production Act (H.R. 486) sponsored by Representative Mary Rose Oakar (D-OH) which would limit DoD procurement of critical technologies/items, subject to waiver only on national security grounds, to domestic sources within 5 years. Prior to strong Administration opposition, Representative Oakar's bill had called for limiting all DoD procurements to domestic sources.

LMI Recommendations

In view of U.S. industry's concerns with defense trade offsets, we recommend that the Under Secretary of Defense (Acquisition), in coordination with the Director, DSAA:

- Reject all offset demands made in connection with a potential U.S. defense export only when the U.S. export faces no foreign competition offering offsets.
- Emphasize eliminating or regulating indirect offsets and "buybacks" rather than licensed production and coproduction as forms of direct offsets, in pursuing negotiations, mandated by the FY89 DoD authorization act, to limit the adverse effects of offsets.
- Pursue international offset negotiations with G&R procurement MOU partners. Defense trade offsets contrast sharply with the spirit of those agreements, the renegotiation of which presents the most obvious backdrop for discussions on limiting offsets. A conference should be convened to negotiate simultaneously with all partners.
- Consider abrogating access to our defense market for those G&R procurement MOU partners or other nations that are not willing to address offset limitation in a multilateral forum.

CHAPTER 4

INDUSTRY RECOMMENDATIONS ON TECHNOLOGY SECURITY AND THE EXPORT LICENSING PROCESS

INTRODUCTION

Industry recommendations on technology security and the export licensing process fall into two categories. The first deals with technology transfer, information security, and third-party sales. The second deals with improving the U.S. Government export licensing processes for defense exports and the determination of foreign availability. The recommendations emerged from three working groups. Recommendation numbers are those used in the January 1989 conference report. Again, we present our recommendations following a discussion of industry's recommendations in each of the two categories.

TECHNOLOGY TRANSFER, INFORMATION SECURITY, AND THIRD-PARTY SALES

U.S. Industry Issue

The United States should establish technology restriction practices for countries with which it has agreements on collective security (e.g., NATO), reciprocal procurement (e.g., MOU countries), or multilateral export control [e.g., Coordinating Committee for Multilateral Export Controls (CoCom)] that are different from those for neutral, nonaligned, or communist bloc countries. This is particularly important when Government-sponsored international programs to satisfy U.S. requirements are involved. Specifically, the United States should routinely pre-approve release of technology associated with cooperative R&D programs to participating MOU-signatory NATO and non-NATO allied nations. Any restrictions on future third-party transfers or sales should be clearly defined in the program MOU, with reference to specific technology, destination, and timeframe for controls.

Also, the United States should routinely exchange classified and unclassified solicitations with countries with which it has G&R procurement MOUs. Reciprocity should apply for all systems and technologies not otherwise covered by statutory "buy

American" or "black program" restrictions. Industry believes that it should have the right to request exceptions to National Disclosure Policy (ENDP) directly from the NDP Committee (NDPC) rather than having to obtain DoD or other U.S. Government agency sponsorship. Finally, the United States should refrain from applying the Militarily Critical Technologies List (MCTL) to decisions on exports to its CoCom partners. (*Recommendations 3-5, 5-1, 5-3, 5-4, 5-5, and 5-6*).

Discussion

Background

This section deals with the problem of managing the transfer of technology to allied and friendly nations under a licensing and technology control regime that was designed to restrict Eastern bloc access to militarily critical Western technology. Industry representatives complain that the U.S. Government's support for international armaments cooperation, which was articulated in a 6 June 1985 Secretary of Defense memorandum and has been reinforced annually by Congress ever since passage of the "Nunn Amendment" to the FY86 DoD authorization act, is effectively undermined if technology security policies prevent the transfer of technology required for a cooperative project that is already agreed to under a government-to-government MOU.

Increasingly, restrictions are imposed for economic and commercial reasons rather than because of national security or foreign policy considerations. The latter considerations have traditionally motivated U.S. control of militarily critical technology. In this context, "national security considerations" include preventing our military adversaries from acquiring technology developed by the West to offset the numerical superiority of Soviet forces. "Foreign policy considerations" include withholding Western technology from certain countries in order to preserve regional balances of power or to pressure states to modify their domestic or foreign policies.

In 1988, restricting technology transfer for economic or commercial reasons became a major new concern of Congress. That year, Congress used the National Defense Authorization Act to prevent DoD from entering into any MOU requiring the transfer of U.S. technology if the transfer would "significantly and adversely affect the defense industrial base of the United States and would result in a substantial financial loss to a United States firm" [10 U.S.C. 2505(b)].

Congress also required the Secretary of Defense to consult with the Secretary of Commerce in the negotiation of program MOUs to ensure that commercial and industrial base considerations are taken into account (10 U.S.C. 2504). By mid-1990, approximately 110 program MOUs had been reviewed by the Commerce Department's Bureau of Export Administration (BXA). The FY91 DoD authorization act (see section 1453) expands this requirement to include consultation with Commerce on all G&R procurement MOUs. The new rationale for technology controls was applied during the debate within the Administration early in 1989 over the U.S.-Japan FSX fighter codevelopment program. Thus, export controls and technology security policies have acquired a new and powerful role at the same time that the Administration is actively pursuing collaboration with major allies in the research, development, and production of defense systems.

Technology Security in Cooperative Projects

Provisions on technology release, foreign disclosure of technical data, and third-party sales can generally be determined at the time of full-scale engineering development for most FMS or DCS cases. Also, for licensed production or coproduction programs, technology transfer requirements can be defined at the time government-to-government or industry-to-industry agreements are negotiated. This is so because the technology resident in the fully developed end item is largely known, and technical data packages can be evaluated against the various control lists administered by the U.S. Government (see discussion below). For cooperative R&D programs, however, the process of evaluating the sensitivity of the technology for release determination is more difficult, because the technology that will be generated in the course of the program is not known and the technical data are uncertain.

As part of the process of submitting to OSD a request for authority to negotiate (RAN) an international agreement for a cooperative project, a DoD Component must prepare a Technology Assessment/Control Plan (TA/CP), formerly a Technology Security Risk Assessment (TSRA) (see DoDD 5530.3, *International Agreements*). The TA/CP provides details of the program (e.g., requirement/threat, participating countries, milestones/schedule); identifies associated technologies in terms of the MCTL and classification in terms of the National Disclosure Policy (NDP); describes past disclosure or release approvals by the U.S. Government and the state of foreign availability; and assesses the benefits to the United States of participation, the

consequences of unauthorized disclosure, and the risk or probability of compromise. Finally, the TA/CP presents a detailed plan for phased, selective release of technical information and technology, and the procedures to govern such release during the program's life.

The TA/CP is prepared in cooperation with the Defense Technology Security Administration (DTSA), the Deputy Under Secretary of Defense (Security Policy) [DUSD(SP)] in the case of classified foreign disclosure, and DoD Component officials responsible for technology security. The TA/CP is used by the DoD Component to develop MOU negotiation guidance on which technologies or information can and cannot be exchanged, as well as on which can be exchanged on a limited basis. DoD Components must also develop a Delegation of Disclosure Authority Letter (DDL) as part of a request for authority to conclude (RAC) an international agreement. The DDL gives details on the releasability of all aspects of the technology or system in question (e.g., disclosure methods, highest classification, specific information to be withheld, etc.).

An objective of preparing a TA/CP is to define the terms and conditions for technology transfer as early as possible in a cooperative program and to coordinate with the DoD technology transfer community (e.g., DTSA) well in advance of initiating the export licensing process. The more advance work that is done that reflects realistic technology transfer arrangements, and the wider the extent of coordination with technology security and licensing officials, the more likely it is that the DoD Component will be able to avoid bureaucratic obstacles to execution of the MOU that derive from technology security-related issues. For their part, industry representatives must identify clearly the particular government-to-government agreements within which they make any applications for munitions or other export licenses.

Blanket approval of export licenses in support of an international agreement is possible only if the technical assessments performed by DoD and other agencies regarding the licenses can be done at the time of MOU negotiation. This would be nearly impossible in the case of cooperative R&D programs in which the precise technologies and information to be exchanged during the program's life cannot be determined in advance. For such cases, the TA/CP should define comprehensive

technical criteria for release/disclosure to support release decisions as the program evolves.

Third-Party Sales Restrictions

This problem is closely related to the problem of restrictions on third-party sales associated with FMS and DCS. U.S. policy in this area is simple and is a standard "boilerplate" item in FMS LOAs and cooperative program MOUs: defense technology transferred or items sold through approved U.S. Government channels cannot be transferred or sold to third parties without prior written approval of the U.S. Government. (Approval can, however, be given in advance for specified items and destinations.) Restrictions apply equally to all firms that contract with each party. In general, the AECA seeks to apply the same control on third-party sales of an item as it would for sales of the item from the United States. This application of "extraterritoriality" is often one of the principal points of dispute during MOU negotiations. Industry contends that these restrictions frequently result in the practice by our defense trade partners of designing U.S. components and technologies out of end items they develop for third-party sales, with resulting negative impact on the U.S. defense industrial base and export posture. In codevelopment and licensed production or coproduction programs, this practice is particularly attractive with smaller partner countries that require large export orders to achieve economies of scale and to justify investment in tooling and other physical capital. A key issue in such negotiations is which party to the agreement owns or controls which technology.

Third-party sales restrictions in the non-munitions area have been more flexible. Since 1985, U.S. policy has allowed for reciprocal elimination with CoCom partners of export licensing requirements in most commercial third-party sales of technology or items of U.S. origin (supercomputers, however, are an example of an exception) [see 50 U.S.C. 2404 (a)(4)]. Third-party U.S. sales restrictions are entirely eliminated for any item requiring only routine CoCom notification and when the U.S. content of the end item is 25 percent or less [see 50 U.S.C. 2404 (a)(5)]. Congress established these decontrols in the Omnibus Trade and Competitiveness Act of 1988.

Foreign Disclosure and Responses to RFPs

Foreign industry representatives have frequently complained that U.S. foreign disclosure regulations restrict fair competition for many DoD solicitations. Little or no time to meet RFP suspenses may be left by the foreign disclosure and export

license reviews required for the release of classified military information (CMI) or controlled unclassified information (CUI) used in the preparation of proposals to respond to DoD solicitations. Two related issues are discussed in Chapter 2: U.S. Government support to U.S. industry in circulating foreign materiel requirements documents (MRDs) and foreign RFPs and U.S. Government procedures for securing industry comment (both foreign and domestic) on U.S. MRDs.

U.S. program managers (PMs) and procuring contracting officers (PCOs) should develop foreign disclosure guidance as early as possible in the pre-solicitation process to identify any CMI/CUI-related obstacles to foreign industrial participation in the program. Any decision to restrict disclosure to a country that has a signed G&R procurement MOU with the United States must be made before the RFP is published in the *CBD* and so stated in the announcement. The *CBD*, which usually publishes solicitation synopses 15 days before an RFP is distributed, is available to both foreign and domestic prime contractors interested in responding to an RFP. Foreign contractors may ask to be placed on the solicitation mailing list of a DoD contracting activity (e.g., an AMC MSC), by submitting a completed Standard Form 129, "Solicitation Mailing List Application," to the activity. [For a discussion of the special requirements and conditions for release of CMI/CUI to U.S. contractors under foreign ownership, control, or influence, see the DUSD(SP) memorandum "Release of Export Controlled Technical Data to Foreign-Owned U.S. Firms."]

For U.S. prime contractors that seek foreign teaming partners or subcontractors when responding to U.S. RFPs that do not contain guidance on foreign participation, U.S. Government contracting officials have suggested either of two approaches. First, U.S. primes can ask the PCO to deliver technical or other CMI/CUI data required to respond to the RFP directly to the foreign partner or subcontracting firm through government-to-government channels, eliminating the need for an export license for an industry-to-industry transfer. Second, the U.S. prime can ask the PCO to provide written endorsement of the particular industry-to-industry disclosure on the export license application, to expedite State Department review of the application. Otherwise, there is no procedure outside of the normal licensing process for U.S. industry to exchange CMI/CUI with foreign industry in support of proposal preparation.

Exceptions to National Disclosure Policy

To expedite exchange of CMI/CUI, industry has proposed that it be permitted to request ENDP associated with an export license application directly from the NDPC rather than be required to lobby U.S. Government officials to request ENDP on its behalf. Basic U.S. policy in this area is contained in *National Policies and Procedures for the Disclosure of Classified Military Information to Foreign Governments and International Organizations* (NDP-1). The Office of the Deputy Chief of Staff (Intelligence), HQDA, is the Army office of record for ENDP actions. Government officials consulted in preparation of this report were not sympathetic to industry's proposal and pointed out that CMI and CUI are, of course, originated and controlled by the U.S. Government, unlike hardware that industry has developed and produced and for which it seeks an export license.

American industry has attempted to draw parallels between the process by which it initiates export license applications and the process by which the U.S. Government evaluates ENDP. Defense officials feel, however, that the originators of CMI/CUI are in the best position to evaluate needs for disclosure and to justify requests on the basis of national interest, foreign policy considerations, and potential benefits to the U.S. Government as well as the risk of unauthorized further disclosure. Often the originator of specific U.S. CMI/CUI is the same official (e.g., PM) that industry approaches to request that an ENDP be placed before the NDPC. All indications are that the requirement for industry to request sponsorship for considering an ENDP does not constitute a bureaucratic burden and should continue.

This discussion of foreign disclosure and NDP would not be complete without reference to the DoD Foreign Disclosure and Technical Information System (FORDTIS). Operational since 1984, FORDTIS is an on-line, interactive database administered by the DUSD(SP) and used by DoD in providing technical evaluations for export license applications and foreign disclosure cases. Export license applications submitted to the Department of Commerce or the Department of State that require DoD technical evaluation are logged onto FORDTIS, as are foreign disclosure and ENDP cases. FORDTIS combines a historical record of past licensing and disclosure cases with information on applicable CoCom and U.S. agreements, laws, and regulations; intelligence reports on hostile foreign efforts to acquire technology; the results of consultations with the Military Services and Defense Agencies; decisions taken by the NDPC and its designees; and the final DoD

disposition of export license cases. FORDTIS was augmented in 1985 with an FMS case history database, updated monthly, providing users with data on all items of equipment transferred through the FMS program since 1982. Nevertheless, industry still maintains that the Army does not have sufficient information resources at its disposal to render well-informed decisions on foreign disclosure requests and ENDP.

The MCTL and Trade Within CoCom

Industry has also expressed concern that the MCTL has been used to restrict technology transfers to CoCom destinations, in addition to its original intent of identifying key technologies that DoD seeks to prevent from release to CoCom-proscribed countries. Industry argues that DoD technology security policies and procedures do not adequately differentiate among allied and friendly countries, neutral and nonaligned countries, and Soviet bloc countries, nor do they adequately account for export control mechanisms, which our CoCom partners use, that are designed to prevent unauthorized release of U.S. technology to third parties.

DoD officials point out that the MCTL is not a control list *per se* as is the U.S. Munitions List (USML) or the U.S. Commodity Control List (CCL), but is instead a document identifying technologies considered militarily critical by DoD that is used to help develop policy and technical guidance on DoD technology security policies. Requirements for DoD to maintain the MCTL were established by the Export Administration Act (EAA) of 1979 and reaffirmed by amendments in 1985. Among other things, the 1985 amendments to the EAA mandated that DoD, in consultation with U.S. industry, establish mechanisms to improve the MCTL review process to ensure that the list reflects the current state of foreign availability [50 U.S.C. 2404 (d)(4)] as well as the emerging state-of-the-art technologies, while removing those items no longer considered militarily critical [50 U.S.C. 2404 (d)(5)]. Industry has played a significant role in developing the MCTL, with representatives serving as full members of the technical working groups established by the Deputy Under Secretary of Defense (International Programs) [DUSD(IP)] to review the MCTL's contents. Finally, the 1985 EAA amendments called for the MCTL to be incorporated into and coordinated with the CCL and USML. In the multilateral sphere, the MCTL has been used in periodic reviews of the CoCom International List and is one of the principal inputs for proposals tabled by the U.S. delegation to CoCom.

LMI Recommendations

In response to U.S. industry's concerns with current Government policy on technology transfer, information security, and third-party sales, we recommend that:

- U.S. Army and OSD officials responsible for granting authority to negotiate or conclude program MOUs require MOU negotiating teams to coordinate with DTSA and, when appropriate, the State Department Office of Defense Trade Controls (ODTC) and NDPC officials at the earliest possible time in proposing a cooperative program, to obtain clear guidance on the technology and information security and release policies that pertain to the proposed program, potential program partners, and possible third-party sales customers.
- The Assistant Secretary of the Army (Research, Development and Acquisition) [ASA(RD&A)], with the support of the Army Deputy Chief of Staff for Intelligence, establish and publish guidelines for the reciprocal exchange of information on classified solicitations between U.S. industry representatives and representatives of the industry of G&R procurement MOU partner countries. We further recommend that some government-to-government channel other than one involving NDP or formal export licensing be established to facilitate exchange of non-CMI/CUI technical data between domestic and foreign industry representatives responding to solicitations.
- The Director, DTSA, designate the Army PM of the international cooperative program to be the principal technical authority for determining – during DoD review of an export license application – whether the technology to be exported meets the criteria for transfer agreed to in the MOU, with the proviso that a decision to deny an application be ratified by the Army Acquisition Executive (AAE).
- The USD(A), with the support of the Director, DSAA, sponsor a study to determine the commercial, economic, and security implications of amending the AECA to permit pre-approval of third-party transfers of defense items on a reciprocal basis within CoCom, along lines similar to those now used for commercial commodity licenses.
- The USD(A) publish in the *CBD* or the *Federal Register* any procedures developed in response to 10 U.S.C. 2504 for consultation with the Department of Commerce on the U.S. industrial and commercial implications of any proposed cooperative program MOU.

IMPROVING THE U.S. GOVERNMENT EXPORT LICENSING AND FOREIGN AVAILABILITY DETERMINATION PROCESSES FOR DEFENSE EXPORTS

U.S. Industry Issue

The U.S. Government should improve its response time on munitions and dual-use export license applications. Steps necessary to achieve this objective include improved coordination among the agencies involved, a reduction of items on the USML of the International Traffic in Armaments Regulations (ITAR), and increased automation and personnel resources, particularly for the State Department. Also, the U.S. Government should improve its mechanisms for determining "foreign availability" in order both to speed its approval of export license applications and to remove items from the CCL and USML that are available in non-CoCom markets in militarily critical quantities of comparable quality and performance to U.S.-controlled items. Administration arms transfer notifications to Congress should include analysis of the foreign availability conditions that obtain in each case. Finally, the U.S. Army should establish a single point of contact on export license reviews at each AMC MSC for industry to turn to for information on the status of pending cases. (*Recommendations 2-2, 3-9, 3-10, 5-2, and 5-8*).

Discussion

Background

Two U.S. export licensing regimes derive from the Mutual Security Act of 1954, later supplanted by the AECA of 1976, and from the EAA of 1965 and 1979, as amended in 1985. The State Department ODTC [previously called the Office of Munitions Control (OMC)] administers the AECA through the ITAR, which contain the USML. The Commerce Department BXA administers the EAA through the Export Administration Regulations (EAR), which contain the CCL. The ITAR regulate trade in munitions, while the EAR regulate trade in commercial and dual-use items. DoD, and specifically DTSA, plays a supporting role in export licensing decisions under both regimes by coordinating technical assessments for individual license applications throughout the Department and by maintaining the MCTL as well as a number of automated information resources.

One difficulty with the division between munitions and commercial export license regimes is that the AECA and EAA define a "defense article or service"

differently. The AECA bases determinations on whether an article or service is "inherently military in character," while the EAA classifies items as defense-related if they make a "significant contribution" to a nation's military capabilities. Industry favors standardizing such definitions by focusing on whether the item is specifically developed, produced, or modified for military or intelligence applications. This would remove all items from the USML that industry regards as dual-use or purely civilian.

In the multilateral sphere, the United States participates with Japan, Australia, and all of its NATO allies (less Iceland) in CoCom, which (through the International List) maintains controls against exporting certain dual-use goods to the Soviet Union and associated nations. CoCom also maintains an International Atomic Energy List and International Munitions List for controlling goods in those categories.¹ Decisions in CoCom are normally made on a consensus basis, but enforcement is the responsibility of sovereign member nations. Finally, the United States has a number of bilateral and multilateral export control relationships with allied and friendly nations, such as the Missile Technology Control Regime.

Export Licensing Delays

Estimates of the extent of export license processing delays vary widely. On the one hand, DTSA claims that munitions and West-East dual-use licenses are processed in as a few as 15 or 16 days (though the Army's internal reviews alone are claimed to average 10 to 12 days), while the DPACT has cited turnaround times of as much as 75 days. More recent estimates of overall turnaround time for munitions cases, based on recent ODTC figures, are: 71 percent of cases processed in 4 or fewer business days (non-DTSA cases), 28 percent take as many as 36 business days (DTSA cases), and the remaining 1 percent take longer than 36 business days.

In general, DoD attributes delays to the need to handle incomplete industry license application packages, as well as to cumbersome DoD contracting procedures in the case of exports through the FMS program. DoD supports the view that ODTC, in contrast to the BXA, needs a substantial increase in staff and automation resources. Industry blames the staffing process -- which can involve the State Department; several agencies within OSD [e.g., DTSA, DUSD(SP), and DSAA];

¹A proposed amendment to the EAA, under review for reauthorization in October 1990, will prohibit, in all but exceptional circumstances, adding items to the USML that are not on the CoCom International Munitions List.

several agencies within a Military Department (particularly its program management community); and several intelligence agencies – for delays in munitions license applications.

Industry points to the extremely low rejection rate for munitions licenses (a figure that DTSA itself has estimated at 7 percent) as an indication that the USML is too long and contains too many relatively noncritical technologies or ones that are widely available in foreign markets. This argument is not entirely convincing: the low rejection rate may be more indicative of the correctness of the applications submitted, the integrity of the firms submitting them, and the routine nature of many munitions destinations. After all, individual munitions licenses are required each time an item on the USML is to be exported. That is, there are no "bulk," multiple-transaction munitions licenses, as there are in commercial exports (i.e., distribution-validated licenses). The criticism that the list of technologies is too long may be more appropriately directed at the CCL; the latter has expanded with the addition in 1990 of over 80 controlled technologies formerly on the USML.

While industry has advocated a substantial updating of ODTC procedures and use of automated decision support and management information systems, until now DTSA seems to have been the chief beneficiary of automation in the export license review process. The centerpiece of this automation was to be the High Technology Analysis and Control System for the 1990s (HI-TRAC 90). HI-TRAC 90 was conceived as an automated decision support architecture for assisting the export license review process; developing critical technologies lists (e.g., MCTL); analyzing the trade, fiscal, and economic impacts of technology transfers and unauthorized disclosures; and assessing the foreign availability conditions relating to a proposed export. HI-TRAC 90 was designed to serve as the hub for DTSA's use of technology security information systems, including SOCRATES (administered by DIA for the conduct of foreign availability assessments) and FORDTIS (for CML/CUI disclosure cases). Recent DTSA resource constraints have effectively terminated HI-TRAC 90, shifting responsibility for many of its functions to FORDTIS.

Recent Organizational and Procedural Changes

The defense sales and munitions licensing communities at the State Department were reorganized into a Center for Defense Trade (CDT) effective 8 January 1990. The Center now comprises an Office of Defense Trade Controls

(ODTC, formerly OMC) and an Office of Defense Trade Policy (ODTP). Current plans call for CDT to receive a staff increase of 30 to 35, mainly in ODTC, and an additional \$1.5 million for upgrading computers and other automation. ODTC has considered enabling industry to file munitions license applications through on-line electronic means but is concerned that applications would not be prepared with adequate care; for now, ODTC has decided against this option. In general, the investment in upgraded automation is designed both to speed the license approval process and to improve information sharing among the Department of State and other agencies in reviewing applications. The reorganization reflects a renewed appreciation for the foreign policy, military, and commercial value of defense sales by the Department of State.

A recent development within the DTSA license review process is the "day in court" procedure. For applications it expects it will recommend be denied by ODTC, DTSA will first notify the applicant and provide its rationale. The applying firm will have 3 days to indicate any interest in pursuing an appeal. If it chooses to appeal, the firm must submit a "white paper" to DTSA within a further 10 days, refuting in detail DTSA's concerns with the application or providing clarification. After receipt, DTSA will schedule a face-to-face meeting with the firm within 15 days to discuss the "white paper" and all outstanding problems with the application. Within an additional 10 days of this "day in court," DTSA will make its recommendation to ODTC on the application or seek additional information from the firm. DTSA stresses that the "day in court" is designed to review inadequacies with the application itself rather than to debate existing U.S. Government munitions control policies as they apply to the particular case.

Foreign Availability Assessments

Although foreign availability determination has become one of the most important features of the export licensing process, it is not well practiced within the U.S. Government. The benefits of applying foreign availability determinations to the licensing process are obvious. They include providing license approval when a finding is made that the technology in question is available from noncontrolled sources, reducing the lengths of the USML and the CCL and simplifying future reviews, and making the case that there are viable competitors abroad willing to gain market share from the United States for high-technology products. The increased attention to the foreign availability issue reflects a realization that the United States

is no longer the sole source for many products critical to military operations and that unilateral controls can result in loss of market share while no benefits are achieved from denying the technology transfer.

Congress underlined the importance of foreign availability determinations during markup of the FY90 foreign assistance authorization act. Both the House and the Senate versions of the bill (H.R. 2655 and S. 1347, respectively) would have amended the AECA to require foreign availability and broad commercial and economic assessments to be presented to Congress together with notifications on arms transfers and commercial licensed production deals.² A precedent was set for such assessments when the Administration provided Congress with a detailed study of the domestic economic impact of the M-1A2 tank coproduction program with Egypt. Congress might have reconsidered its decision to bar sales of advanced fighter aircraft to Saudi Arabia had it realized the ease with which British Aerospace would be able to conclude deals with that country and Malaysia during 1988 for exports of its Tornado and Hawk aircraft.

Congress' recognition of the importance of foreign availability was earlier reflected in the 1985 amendment to the EAA, which established an Office of Foreign Availability (OFA) in the BXA. The OFA conducts periodic foreign availability reviews in connection with annual CCL updates and other foreign availability assessments on its own initiative or at the request of a license applicant or other interested party. The speed and effectiveness with which such determinations are made, notwithstanding the augmentation of the licensing community's staff, have been questioned by some in industry. Congress currently mandates a 4-month deadline for determining whether or not foreign availability conditions apply. But the General Accounting Office (GAO) has found that these assessments take an average of 16 months to complete. The GAO has attributed such delays to difficulties the Department of Commerce has encountered in obtaining evidence of foreign availability and to a reluctance to make positive foreign availability determinations without DoD concurrence.

²A foreign assistance authorization act was never passed in FY90 (instead, the Government relied solely on an appropriations act), and the existing provisions in the AECA on foreign availability reporting [22 U.S.C. 2776 (b)(1)(K)] continue without the broader requirement for economic impact assessments submitted with sales notifications.

After initial foreign availability determination, the Commerce Department is obliged to solicit (but not necessarily accept) DoD and other agency views on foreign availability conditions; however, the GAO found that these consultations have not been effective. Moreover, in a separate study, the GAO found that a number of Federal departments and agencies maintain foreign availability databases with no central coordination or information source. These include the Departments of Commerce, Defense, Energy, and State; NASA; the intelligence agencies; and several other U.S. Government activities. Within DoD alone, the Office of the Under Secretary for Acquisition, the Defense Advanced Research Projects Agency (DARPA), DIA (SOCRATES), and the Services [e.g., the U.S. Army prototype Foreign Market Analysis System (FMAS)] each maintain foreign market and technology availability databases. However, DTSA, responsible for coordinating DoD's export licensing reviews, does not maintain a foreign availability database *per se*. In July 1987, the Commerce Department began a formal process for notifying other agencies of foreign availability assessments, to solicit all pertinent information.

Export License Advocate

Finally, industry recommended that a single export license point of contact be designated at each AMC MSC to consult on the status of pending cases. At the November 1988 conference, Army officials declared that the heads of the security assistance and international logistics offices at each MSC, whose names, addresses, and phone numbers were distributed at the conference, would serve as dedicated export license contacts. In October 1989, USASAC provided a statement for this report that all export license inquiries from industry should be routed through the USASAC Office for International Industrial Cooperation (AMSAC-MI).

In May 1985, DTSA established the Export License Status Advisor (ELISA). ELISA is an on-line electronic bulletin board, updated daily through FORDTIS, that appraises the user of the status within DoD of munitions and dual-use export license applications referred by the Commerce and State Departments. It provides dates that license cases were referred to DoD, their status if pending, and recommended disposition if returned to the Departments of Commerce and State. An artificial intelligence application with ELISA — known as EXPERT — assists exporters in determining what export controls and licenses apply to particular technologies. ELISA FAX allows exporters to send technical diagrams and supporting

documentation electronically in connection with license applications. DTSA's License Directorate can respond to similar inquiries over the phone for firms unable to use ELISA. The Automated License Status System (ALISS) was established in 1990 at ODTC to provide dial-up, touch-tone, interactive voice mail responses regarding pending munitions license cases. (Information on each of these license status services is contained in Appendix D).

In a recent report, *Export Controls: Advising U.S. Business of Policy Changes*, the GAO found that while the United States has improved, it still lags behind many member countries in incorporating changes to CoCom lists and regulations into U.S. regulations (i.e., EAR and ITAR). Furthermore, the GAO found that the United States fails to disseminate to U.S. industry, in an equitable manner, information on exceptions granted by CoCom regarding controlled commodities or on precedent-setting U.S. licensing decisions. The GAO concluded that this failure may put U.S. exporters at a competitive disadvantage relative to foreign firms that may be better apprised of such actions. While beyond the scope of the industry concerns addressed in this report, resolution of this issue may soon emerge as a top priority of U.S. suppliers.

Recent Dual-Use Export Policy Developments

On 19 January 1990, the President's National Security Advisor approved an initiative for significantly liberalizing controls on commercial exports to Eastern Europe of telecommunications, machine tools, and personal computers. This initiative would relax controls for certain Eastern European nations to levels approaching those allowed through the so-called (People's Republic of) "China Green Line." The United States tabled this proposal at a February 1990 CoCom Executive Committee meeting, which directed expert working groups to study the exact level of releasability for each of these three goods. A separate working group was established to resolve the issue of differentiation on controls between the Soviet Union and its Eastern European allies. These reports were completed in May in advance of the June CoCom ministerial.

The 6-8 June 1990 CoCom High Level Meeting agreed to decontrol exports to Eastern Europe of telecommunications with transmission rates of up to 45 megabits per second, machine tools with a positioning accuracy of 2 to 3 microns, and personal computers with data processing rates of up to 275 megabits per second. In addition,

the meeting agreed to decontrol over one-quarter of the items on the CoCom International List and to develop a new "Core List" of controlled dual-use goods and technology before 1991. Finally, CoCom adopted a still shorter list of controls on exports to Czechoslovakia, Hungary, and Poland, if those countries adopt safeguards to prevent further release to other CoCom-proscribed destinations. East Germany was given a special status in view of its reunification with West Germany.

At the same time, the NSC staff launched three interagency reviews for completion during 1990: the Joint Chiefs of Staff evaluated the military implications of relaxed technology transfer controls; the intelligence community addressed the continued clandestine efforts of Warsaw Pact nations to acquire Western technology; and the Commerce Department is chairing a broad interagency review of the full range of U.S. commercial export control policies, including substantial liberalization of licensing requirements for exports to other CoCom countries. Conclusions from the first two studies persuaded the Administration to initiate the third. One of the early results of this last review is the creation of a new category of General License (i.e., GCT), effective 2 July 1990, which allows U.S. exporters to ship certain items to CoCom destinations without securing individual licenses. Obtaining a GCT would require simply verifying the *bona fides* of a CoCom-member importer. Added to other CoCom General Licenses (e.g., G-COM), this new license should substantially reduce the requirements of U.S. industry to submit individual export applications for many items intended for CoCom destinations.

Meanwhile, during the debate on reauthorizing the EAA, which expired at the end of FY90, an amendment was considered that would have established an Office of Strategic Trade and Technology (OSTT) combining BXA, ODTC, and DTSA. The proposed OSTT would be established as a cabinet-level agency within the Executive Office of the President, parallel to the NSC staff and OMB. It would be overseen by a Strategic Trade Policy Council, chaired by the OSTT director, whose members would include the Secretaries of Commerce, Defense, State, and Treasury; the U.S. Trade Representative; and the Director of Central Intelligence. The proposed OSTT would be responsible for maintaining a consolidated U.S. export control list and for providing technical support and approval for all export licenses. In the past, Congress has considered consolidating the export licensing bureaucracies and adopting other measures to streamline the process; however, once again the scope of such a reform exceeded the political realities of reauthorizing the EAA, and the

OSTT proposal has been shelved. At the time of publication, the EAA had expired and the Government was operating under the stopgap terms of the International Emergency Economic Powers Act.

LMI Recommendations

In view of industry's concerns for improving both the export licensing process and the determination of foreign availability of sensitive technologies, we recommend that:

- The ASA(RD&A), with support from the Commanding General, AMC, assign to PMs for cooperative programs responsibility for (1) keeping industry informed on the status of all export licenses required and submitted in the conduct of their programs, and (2) acting as advocates, as necessary, in ushering export license applications through the appropriate approval processes. Since they have a direct stake in efficient processing of export license applications, PMs are more suited to this role than would be the single official at each MSC as industry recommended. However, for FMS and DCS cases, AMSAC-MI should continue to serve as industry's point of contact on the status of munitions licenses.
- The NSC sponsor a study to assess the relevance and utility of various Government-sponsored information systems on the foreign availability of sensitive technologies. The study should consider the feasibility and desirability of establishing a single database or a "gateway" among existing databases to achieve effective information sharing and shorten the time required for foreign availability determinations. Only as the turnaround time for foreign availability assessments approaches that of other aspects of export license reviews will it be possible to link negative foreign availability determination to denial of non-munitions export licenses.

CHAPTER 5

ADDITIONAL INDUSTRY RECOMMENDATIONS

INTRODUCTION

Industry recommendations discussed in this chapter are organized in two categories. The first deals with U.S. Government contracting, procurement, and investment policy. Unlike the issues in the previous chapters, this issue is generally beyond the scope of this study. The second addresses industry recommendations that were either too broad to be classified in the preceding chapters or were hortatory in nature. The recommendations emerged from two working groups and from the Army panel. Again, recommendation numbers are those used in the January 1989 conference report. Our recommendations are presented after a discussion of the issues raised by industry.

BOLSTERING U.S. DEFENSE INDUSTRIAL COMPETITIVENESS AND U.S. GOVERNMENT PROCUREMENT POLICY

U.S. Industry Issue

The U.S. Government should increase investment in the domestic defense technology and manufacturing base by funding independent research and development (IR&D) and modernization of production process technology, by providing incentives for engineering education and professional development for U.S. nationals, and by protecting intellectual property rights in foreign markets. Furthermore, DoD should streamline its acquisition system, particularly the source selection process, and modify competition rules affecting international programs to allow work share and source selection decisions to be based on national cost shares rather than on low-bid competition. Finally, the U.S. Army should recommend to Congress that international programs be funded on a multiyear basis to ensure program stability and compatibility with partner nations. (*Recommendations 3-2, 3-14, 3-16, and 5-9*).

Discussion

DoD Acquisition Policies

Currently, DoD reimburses industry for a portion of its expenditures on IR&D and bid and proposal (B&P). In recent years, the ratio of the former to the latter has been declining. This trend reflects increasing regulation of the procurement source selection process and decreasing investment in long-term technology base development. DoD recognizes that both are legitimate costs of doing business with the U.S. Government and that IR&D is a necessary cost of ensuring U.S. industry's competitiveness in international markets. Expenditure by U.S. industry on IR&D establishes a base for developing advanced concepts and technologies that can directly influence future requirements and military capabilities. Against the backdrop of declining IR&D investment relative to B&P expense and ceilings on IR&D reimbursement by DoD is the problem of conflicting Service procedures for evaluating IR&D requests and allocating funds. Both DoD and industry managers recognize the inefficiency and complexity of the cost recovery processes for IR&D and B&P, and numerous proposals have been made to streamline the processes and to increase the payoff for these expenditures. The FY91 DoD authorization act (see section 824) allows industry to recover on DoD contracts a share of IR&D devoted to non-defense research related to DoD-critical dual-use technologies or to environmental matters (i.e., to technology areas beyond the traditional defense-only focus of the IR&D program).

A number of DoD acquisition practices have over the years combined to limit U.S. industry incentives to invest in more efficient manufacturing processes, plants, and equipment. First is DoD reliance on firm-fixed-price contracts for full-scale engineering development, which sharply limit incentives for taking technological risks, and on cost-reimbursement contracts for production, which tend to reward the least efficient producers. Second is emphasis in source selection decisions on lowest price offered, at the expense of fully considering life-cycle cost, past contractor performance, and reliability, maintainability, and producibility. Third is increased DoD pressure for contractor assumption of the costs and risks of development and production, including practices such as requiring contractor financing of project-specific tooling and test equipment.

Many of these issues were addressed in the report of the Under Secretary of Defense for Acquisition [USD(A)] on *Bolstering Defense Industrial Competitiveness* (July 1988), and more recently by the Defense Policy Advisory Committee on Trade (DPACT), by the Defense Manufacturing Board (DMB), by the Defense Science Board (DSB), and in the *Defense Management Report (DMR)* mandated by the President's National Security Review 11 (NSR-11). In addition, a Defense Advisory Panel on Government-Industry Relations (DAPGIR) was established in January 1989 pursuant to section 808 of the FY89 DoD authorization act. Composed of industry and DoD members, DAPGIR is specifically responsible for addressing contractor suspension and debarment, industry ethics and self-governance, and alternative government-industry dispute resolution mechanisms.

One effort deserving special mention is the Industrial Modernization Incentives Program (IMIP), established in August 1985. IMIP is designed to reward contractors for investment in modernized plant and equipment that results in reduced product cost and production leadtime and enhanced product quality and production surge capability. Following detailed evaluations of existing production equipment and processes used by its contractor, the Military Department negotiates terms for the contractor's financing of specific new manufacturing equipment. If the contractor achieves pre-established cost-saving benchmarks by applying the modernized process or technology, the Military Department provides incentive awards to the contractor.

National Scientific and Technical Education Issues

The defense technology base has been weakened by failure to attract adequate numbers of high-caliber scientists and engineers from among U.S. nationals. This failure is attributable in part to the inability of the defense industry, and particularly the DoD scientific and technical community, to offer to U.S. engineers compensation that is competitive with that offered by the civilian sectors of industry. This applies particularly in fields such as computer science and electrical engineering, where technical professionals have a wide range of opportunities in either the defense or non-defense industrial sectors.

Universities have had similar difficulty in maintaining a high-quality U.S. national faculty in science and engineering disciplines, because of compensation levels that correlate more closely with average college faculty salaries, across the board, than they do with industry salaries. Finally, to the extent that U.S. scientists

and engineers are sensitive to a growing adversarial relationship between the defense industry and the U.S. Government, they may prefer to pursue professional opportunities outside the defense sector. This aversion to defense work is reinforced by the highly regulated and restrictive (with reference to future employment opportunities) environment of U.S. Government-sponsored or -operated laboratories and production facilities.

The USD(A), calling on numerous industry advisory panels (e.g., DSB, DPACT), has examined proposals to rectify the situation through DoD-funded scholarships in engineering and the sciences at selected institutions and by encouraging major U.S. universities, using the influence of DoD contracts, to increase faculty compensation levels in the pure and applied sciences.

Protecting Intellectual Property Rights

The protection of intellectual property rights is one of the principal prerequisites if industry is to assume technical risks and develop leading-edge technologies. Since April 1988, DoD and various industry groups, including the Council of Defense and Space Industries Associations (CODSIA), have battled over the language in several drafts of a new DoD rule in this area. Disagreement has centered on the meaning of the term "developed at private expense" as stated in the draft DoD regulation. In view of its unique relationship with its principal customer, U.S. defense industry feels that the initial DoD language would limit the ability of defense contractors to substantiate claims that technical data had been developed at private expense. At the same time, the Office of Federal Procurement Policy is overseeing development of a single, Government-wide regulation on protection of technical data rights to apply to both military and civilian agencies. Neither of these efforts has come to closure, and it remains unclear how the two sets of rules will be reconciled.

Streamlining the Acquisition Process

Both the June 1986 report of the President's Blue Ribbon Commission on Defense Management ("Packard Commission") and the July 1989 *DMR* provided the DoD and Service leaderships with a broad mandate to streamline the acquisition system. In November 1989, the USD(A) launched a wide-ranging DSB task force on acquisition streamlining, under the *DMR* umbrella. This task force's objective is to

develop an acquisition model that could reduce the cost and schedule of DoD systems on the order of 50 percent below current levels.

The Army has developed the Army Streamlined Acquisition Program (ASAP), which is a tailored life-cycle system management model designed to eliminate specific milestone reviews for certain programs when past experience has shown it possible to do so. In addition, the Army has designated senior acquisition streamlining advocates at both the HQ AMC and AMC MSC levels to oversee the process throughout the Army acquisition community.

Besides eliminating unnecessary program milestone reviews, acquisition streamlining involves simplifying the solicitation, B&P, and contracting processes by eliminating overspecification of requirements. In addition, as mandated by the *DMR*, a "baseline review" designed to remove obsolete, conflicting, and superfluous acquisition regulations has been underway throughout DoD. Finally, the Packard Commission, the *DMR*, and the DPACT have all stressed the importance to DoD of relying on off-the-shelf, nondevelopmental item (NDI) acquisition whenever possible. Reports of the various bodies involved point out that DoD requires highly visible NDI advocates throughout the OSD and Service acquisition communities as well as changes to the Federal Acquisition Regulation (FAR) and the DoD FAR Supplement (DFARS) to specify the streamlined procedures that should be followed for NDI procurements.

Competition in International Programs

One issue that requires particular attention is source selection and the role of competition in international cooperative programs. DoD has generally tried to avoid directly linking cost shares and work shares in a codevelopment program and to treat these issues on their separate merits. Directly linking cost and work shares, in the absence of any other considerations, could result in production inefficiencies, added cost, and diminished product quality.

The United States has traditionally held that cost sharing should be decided on the basis of equity, e.g., equal payment for equal benefit; work sharing should be determined on the basis of efficiency, i.e., by competition among qualified offerors. Cost sharing is an issue principally for the R&D phase of a program, rather than the production phase, pertaining to the question of how to divide investment costs among the participants. The convention among most industrialized nations is that costs in

the feasibility and exploratory development phases should be divided equally among participants, with all having equal rights to any intellectual property generated.

As U.S. participation in international codevelopment programs has increased in recent years, however, DoD has begun to recognize that correlating cost shares with either work shares or "offtake" (share of output) is often a prerequisite for foreign government and foreign industry interest in such programs. Tying work shares to cost shares is reflected in the statutory provisions that require that U.S. funds appropriated for cooperative R&D programs under the Nunn Amendment be spent only on U.S. domestic sources [10 U.S.C. 2350a(d)(1)]. Our European allies have traditionally linked program cost shares with production offtake, particularly in the full-scale development phase, since participating governments generally know what their future offtake requirements will be and can set cost shares accordingly.¹

Linkage between cost shares and work shares has been established in a variety of ways. In the program MOU, the participating governments may emphasize the desirability of having industrial representation from as many participants as possible, or they may actually include specific industrial participation requirements in RFPs issued. In the latter case, the approach adopted most frequently is for the RFP to state that only proposals from multinational teams will be considered, while either leaving the details of work share allocation to the industry teams or requiring that such arrangements be reported on and approved periodically by the participating governments. Alternatively, the RFP can establish either minimum or precise work share allocations expected from successful offerors, or instruct potential offerors that the agreed-upon cost shares, which may reflect expected offtake by each participant, should dictate the exact terms of industrial participation. Many large international programs establish cost shares on the basis of a two-tier principle in accordance with which "full" members retain full rights to technical data and marketing privileges, while "associate" members with smaller cost share obligations have more limited rights in these areas.

Source Selection in International Programs

There are two main approaches to contracting and source selection in international programs. When work shares are divided along cost share lines, each

¹Linking development cost shares to production offtake is, of course, equivalent to dividing total development costs equally among the units of production.

participating government will normally issue RFPs to its national industry using its own contracting procedures for its share of the work to be performed at home. However, 10 U.S.C. 2350b(b) allows the Secretary of Defense or an appropriate designee to award a prime contract or a subcontract to a particular (U.S.) source in fulfillment of an international cooperative program agreement. At the other extreme, when principles of competition govern collective source selection decisions, a lead nation will employ its own contracting procedures to issue RFPs, evaluate bids, and make source selection decisions.

DoD participation in cooperative projects in which other nations' source selection and contracting procedures are used is sanctioned by 10 U.S.C. 2350b(e) as long as competitive practices that do not preclude U.S. sources from participating are employed. For cooperative projects, most U.S. procurement statutes with respect to competition, buy American preferences, and certain other contracting procedures may also be waived under 10 U.S.C. 2304(c)(4) and 2350b(c). Although procedures of a single nation may be employed to manage contracts, decisions will generally be taken through a collective mechanism, with participation from each member nation.

In general, when international programs require the formation of industrial teams to respond to RFPs, advance notification must be provided to the interested firms among the participants, the requirements for competition among domestic firms of a participating member must first be satisfied, and provision must be made to ensure that individual firms and teams from among the member countries have equal time to respond to the RFP. In all cases, the requirements for industrial participation and cooperation must be prescribed in the government-to-government MOU before industry can be expected to respond properly.

Multiyear Funding of International Programs

A final issue in this discussion is that of multiyear funding of international programs. Congress has retained tight control over the appropriations process and clearly prefers annual program/budget reviews, to ensure maximum oversight. By statute, programs are eligible for consideration for multiyear funding only if DoD can demonstrate that a 10 percent or greater savings in procurement costs would result from funding on a multiyear rather than annual basis. Industry argues, however, that adoption by Congress and DoD of multiyear funding would align U.S. funding

practices with those of our potential international partners, many of which currently fund programs on a biennial or multiyear basis.

Our principal defense trading partners do not have parliamentary defense appropriation debates similar to those that occur annually in the U.S. Congress. For most European parliaments, defense spending is reviewed on the basis of 5-year plans, with annual debate focusing on the fifth or sixth year, not the first as in the United States. The principal functions of parliamentary debates in many allied countries are to ensure that the defense ministries remain within the spending plan "top lines" and to make "go/no-go" decisions on major acquisition programs. Funding of the U.S. share of an international program on a multiyear basis (or preferably on a life-cycle or major milestone basis) would improve program stability and make the United States a more reliable partner in international programs. Congress, however, has not been convinced of the merits of this approach.

LMI Recommendations

To respond to U.S. industry's concerns about competition in international cooperative programs, we recommend that the USD(A):

- Ensure that the terms for cost and work shares be agreed on and outlined in the program MOU as early in the life of the program as possible. The MOU must also provide for the addition or withdrawal of participating governments and for adjustment of cost shares if expected offtake demands change over the life of the program, if per-unit production ("offtake") costs vary significantly from estimates made at the time of codevelopment MOU formulation, or if actual work shares vary from those projected in the MOU. Other "external" changes that must be accounted for include variations in exchange rates or a changed fiscal climate in one or more of the participating nations (e.g., if a participating government is no longer able to afford full membership and seeks associate status).
- Present a forceful case to Congress that weapon systems development and production programs, particularly international ones, be funded through program milestones. While it is not practical from either a business or political standpoint to fund programs through their full life, the present practice of annual appropriations (with limited exceptions) is not efficient.

U.S. ARMY POLICY AND ORGANIZATION FOR INTERNATIONAL ARMAMENTS COOPERATION

U.S. Industry Issue

The senior Army leadership must acknowledge that international armaments cooperation is a reality and that cooperative programs can have positive benefits on the U.S. defense industrial base. The Army must communicate its support to the corporate leadership of U.S. defense industry, not just to international marketing officials, and must establish a senior Army international advocate, promulgate clear and authoritative guidance on international acquisition, and develop a professional cadre of international acquisition specialists. (*Recommendations 3-1, 5-7, 5-10, 6-1, and 6-2*).

Discussion

U.S. Army Support for Defense Guidance Provisions on International Cooperative R&D

The clearest statement of Army support for international armaments cooperation is an 8 November 1988 memorandum from the then Army Acquisition Executive (AAE) (now Secretary of the Army) (see Appendix C). Addressed to the Army operational, requirements, and acquisition communities, this memorandum not only embraces international armaments cooperation as an Army acquisition strategy but also supports the ambitious goals for growth in international program funding detailed in the FY90-94 *Defense Guidance* Mid-Term Objective number 271. The latter calls on the Military Departments to invest 10 percent of their RDT&E resources by FY94 in international cooperative programs, with equitable cost sharing arrangements.²

The memorandum calls for the Army Systems Acquisition Review Council (ASARC) to address international cooperative opportunities as an explicit agenda item during all major milestone reviews. To that end, Program Executive Officers (PEOs) and PMs are directed to prepare Cooperative Opportunities Documents (CODs) in accordance with 10 U.S.C. 2350a(e). PEOs and PMs are also directed to conduct (foreign) market surveys to identify NDI opportunities to be assessed through the NATO Comparative Test and Foreign Weapons Evaluation

²The FY92-97 *Defense Planning Guidance*, however, does not restate this objective.

(now combined into the Foreign Comparative Testing) programs. The U.S. Army Training and Doctrine Command (TRADOC) and AMC are to ensure that international cooperative opportunities are identified in the Army's Long-Range Research, Development, and Acquisition Plan (LRRDAP) and the Mission Area Master Plan (MAMP). Finally, TRADOC is to prioritize its materiel-oriented requirements in such a way as to ensure that international program candidates address high-priority requirements, thus ensuring that the Army's international commitments are fully funded.

High-Level Army Advocacy

The 8 November 1988 memorandum of the AAE, issued the day before the start of the Army-industry conference that is the backdrop of this report, designated the Assistant Secretary of the Army (Research, Development, and Acquisition) [ASA(RD&A)] as the Army's advocate for international cooperative programs. Earlier, in July 1987, the AMC Deputy Commanding General for Research, Development, and Acquisition called on the AMC MSC Commanders to designate an "organizational element" within the MSC headquarters to oversee international cooperative programs and to coordinate with and support the associated PEOs/PMs and research, development, and engineering centers. Finally, Army Regulation (AR) 11-31, *Army International Activities Policy*, identifies the proponent for all Army international programs and forums and correlates each with the DoD/Army regulatory authority that it operates under.

Professionalizing the Army International Acquisition Corps

In 1986, DoD established military and civilian spaces dedicated to "defense cooperation in armaments" located at Security Assistance Organizations in Europe and the Far East (see Chapter 2). The civilian billets were designated as "Armaments Cooperation Specialists" (a new career series numbered 1101). Similarly, as noted above, the Army has staffed newly created "international cells" at all AMC MSCs since July 1987, with appropriately trained professionals.

The Army has also recognized the importance of developing a "professional cadre of international acquisition specialists." To assist in developing such a cadre, AMC developed a prototype "Basic Course in International Cooperative Programs," which was offered to three pilot groups of AMC MSC professionals in 1989. The course was designed to expose mid-level Army acquisition officials to international

programs, as a first step in institutionalizing this strategy within the mainstream acquisition community. The program is designed to complement courses offered through the Defense Systems Management College that provide advanced "hands-on" training in the mechanics of international program identification, negotiation, and management.

LMI Recommendations

To affirm the Army's commitment to international cooperative programs, we recommend that the Commanding General, AMC:

- Promote the widest dissemination of the AAE Policy Memorandum No. 88-8 on international cooperation in research, development, testing, evaluation, and acquisition (see Appendix C).
- Sponsor a review to identify any shortfalls in executing the appropriate international cooperative opportunity provisions of AR 70-1, *System Acquisition Policy and Procedures* (especially Appendix D, Table D-1, items 75-76; Appendix D, Section II, paragraph D-6, l and x; and Appendix E), and the AMC/TRADOC Pamphlet 70-2, *Materiel Acquisition Handbook* (especially Appendix K), and develop mechanisms to improve implementation.
- In cooperation with the Army Chief of Staff, sponsor publication of the draft AR 70-41, *International Cooperative Research and Development*, and the draft DA Pamphlet 70-XX, *International Armaments Cooperative Opportunities Plans and the Cooperative Opportunities Document*.
- Establish clear guidelines for staffing international program offices in each MSC and for professional development of the new DoD acquisition career series 1101, "Armaments Cooperation Specialist."
- Sponsor the prototype "Basic Course in International Cooperative Programs" at a suitable Army educational institution and review Army educational programs to determine shortfalls in training for international cooperative programs.

GLOSSARY

AAE	=	Army Acquisition Executive
ADPA	=	American Defense Preparedness Association
AECA	=	Arms Export Control Act
ALISS	=	Automated License Status System
AMC	=	U.S. Army Materiel Command
AMSAC-MI	=	USASAC Office for International Industrial Cooperation
APBI	=	Advance Planning Briefing for Industry
AR	=	Army Regulation
ASAP	=	Army Streamlined Acquisition Program
ASARC	=	Army Systems Acquisition Review Council
ASA(RD&A)	=	Assistant Secretary of the Army (Research, Development and Acquisition)
BXA	=	Bureau of Export Administration
B&P	=	bid and proposal
CAPS	=	Conventional Armaments Planning System
CBD	=	<i>Commerce Business Daily</i>
CCL	=	U.S. Commodity Control List
CDT	=	Center for Defense Trade
CMI	=	classified military information

CNAD	=	Conference of National Armaments Directors
CoCom	=	Coordinating Committee for Multilateral Export Controls
COD	=	Cooperative Opportunities Document
CODSIA	=	Council of Defense and Space Industries Associations
CUI	=	controlled unclassified information
DA	=	Department of the Army
DAC	=	Defense Acquisition Circular
DAO	=	Defense Attaché Office
DAPGIR	=	Defense Advisory Panel on Government-Industry Relations
DARPA	=	Defense Advanced Research Projects Agency
DCA	=	defense cooperation in armaments
DCS	=	direct commercial sales
DDL	=	Delegation of Disclosure Authority Letter
DFARS	=	DoD FAR Supplement
DIA	=	Defense Intelligence Agency
DISAM	=	Defense Institute for Security Assistance Management
DMB	=	Defense Manufacturing Board
DMR	=	<i>Defense Management Report</i>
DoD	=	Department of Defense
DoDD	=	DoD Directive
DPACT	=	Defense Policy Advisory Committee on Trade

DSAA	=	Defense Security Assistance Agency
DSB	=	Defense Science Board
DTSA	=	Defense Technology Security Administration
DUSD(IP)	=	Deputy Under Secretary of Defense (International Programs)
DUSD(SP)	=	Deputy Under Secretary of Defense (Security Policy)
EAA	=	Export Administration Act
EAR	=	Export Administration Regulations
ECHO	=	European Community Host Organization
ELISA	=	Export License Status Advisor
ENDP	=	exceptions to NDP
FAR	=	Federal Acquisition Regulation
FMAS	=	Foreign Market Analysis System
FMS	=	foreign military sales
FORDTIS	=	Foreign Disclosure and Technical Information System
FY	=	Fiscal Year
GATT	=	General Agreement on Tariffs and Trade
GAO	=	General Accounting Office
GCT	=	(type of) General License
GFE	=	Government-furnished equipment
G&R	=	general and reciprocal
HI-TRAC 90	=	High Technology Analysis and Control System for the 1990s

HQ	=	Headquarters
HQDA	=	Headquarters, Department of the Army
ICP	=	international cooperative program
IEPG	=	Independent European Program Group
IMIP	=	Industrial Modernization Incentives Program
IR&D	=	independent research and development
ITAR	=	International Traffic in Armaments Regulations
KFP	=	Korean Fighter Program
LABCOM	=	U.S. Army Laboratory Command
LMI	=	Logistics Management Institute
LOA	=	letter of offer and acceptance
LRRDAP	=	Long-Range Research, Development, and Acquisition Plan
MAMP	=	Mission Area Master Plan
MAP	=	Military Assistance Program
MDE	=	Major Defense Equipment
MCTL	=	Militarily Critical Technologies List
MoD	=	ministry or ministries of defense
MOU	=	Memorandum of Understanding
MRD	=	materiel requirements documents
MSC	=	(AMC) Major Subordinate Command
MTN	=	Multilateral Trade Negotiations

NDI	=	nondevelopmental item
NDP	=	National Disclosure Policy
NDPC	=	NDP Committee
NIAG	=	NATO Industrial Advisory Group
NRC	=	nonrecurring costs
NSC	=	National Security Council
NSR-11	=	National Security Review 11
ODC	=	Office of Defense Cooperation
ODTC	=	Office of Defense Trade Controls
ODTP	=	Office of Defense Trade Policy
OECD	=	Organization for Economic Cooperation and Development
OFA	=	Office of Foreign Availability
OMB	=	Office of Management and Budget
OMC	=	Office of Munitions Control
OSD	=	Office of the Secretary of Defense
OSTT	=	Office of Strategic Trade and Technology
P&A	=	price and availability
PCO	=	procuring contracting officer
PEO	=	Program Executive Officer
PM	=	program manager
RAC	=	request for authority to conclude

RAN	=	request for authority to negotiate
RDT&E	=	research, development, test, and evaluation
R&D	=	research and development
RFI	=	request for information
RFP	=	request for proposals
ROC	=	Required Operational Capability
RSI	=	rationalization, standardization, and interoperability
<i>SAMM</i>	=	<i>Security Assistance Management Manual</i>
SAO	=	Security Assistance Organization/Office
SASC	=	Senate Armed Service Committee
SME	=	significant military equipment
SOI	=	Statement of Intent
STC	=	Science and Technology Centers
TA/CP	=	Technology Assessment /Control Plan
TILO	=	Technical Industrial Liaison Office
TOR	=	terms of reference
TRADOC	=	U.S. Army Training and Doctrine Command
TSRA	=	Technology Security Risk Assessment
UNCTAD	=	United Nation Conference on Trade and Development
USARDSG	=	U.S. Army Research, Development, and Standardization Group
USASAC	=	U.S. Army Security Assistance Command

U.S.&FCS = United States and Foreign Commercial Service
USD(A) = Under Secretary of Defense for Acquisition
USG = U.S. Government
USML = U.S. Munitions List

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APPENDIX A

U.S. ARMY/U.S. INDUSTRY CONFERENCE ON "IMPROVING U.S. INDUSTRY'S ROLE IN INTERNATIONAL ARMAMENTS COOPERATION"

Industry and Government Panel Recommendations

9-10 November 1988, Omni Shoreham Hotel, Washington, D.C.

The following recommendations were made by industry working groups and a U.S. Army expert panel. The four industry working groups addressed: (1) industrial teaming and organization for international programs; (2) preservation of the U.S. industrial base and armaments cooperation; (3) the alliance defense market environment and trade offsets; and (4) U.S. Government technology security policy in support of defense industrial cooperation (recommendations 2-XX through 5-XX, respectively). The senior U.S. Army panel recommendations are numbered 6-1 through 6-3.

- 2-1 The U.S. Army should support a greater role for Security Assistance Offices in marketing U.S. defense products abroad.
- 2-2 The U.S. Army should assign a designated advocate for export license actions at each major subordinate command of the Army Materiel Command.
- 2-3 The U.S. Army should encourage field demonstrations of U.S. equipment in support of approved sales programs.
- 2-4 The United States should consider reduction of recoupment charges on foreign military sales (FMS) and commercial sales on a case-by-case basis.
- 2-5 The U.S. Army should institutionalize advance consultation with industry on international programs. In this vein, the U.S. Army should consider issuing requests for information to obtain industry comment and advice on potential international programs prior to formal memorandum of understanding (MOU) negotiation.
- 2-6 There are three equally valid forms of international armaments cooperation – codevelopment, coproduction, and licensing – and the U.S. Army should affirm that industry-to-industry teaming is the preferred vehicle for each form of international armaments cooperation.

- 2-7 Army MOUs should give due weight to industrial experience in prescribing a management structure for an international program. The management structure should facilitate timely decisions and efficient application of resources.
- 3-1 The U.S. Army and industry should accept the fact that armaments cooperation is a reality and determine how to make the most of it.
- 3-2 The United States should accept a workshare approach as a practical solution to codevelopment programs.
- 3-3 The U.S. Army should ensure industry involvement early in the MOU process.
- 3-4 System designs should include international needs as well as domestic requirements.
- 3-5 The United States should reduce third-country sales restrictions.
- 3-6 The United States should refrain from imposing protectionist barriers and enacting "Buy American" legislation.
- 3-7 The U.S. Army Materiel Command should develop an effective mechanism for communicating international research and development (R&D) and technology capabilities to Army-related industries in the United States.
- 3-8 The United States should pursue a policy that maximizes export promotion (versus protectionism). This can be achieved in part through enlisting support of embassy personnel and providing training programs accordingly, obtaining marketing support at senior levels of the Military Services, and creating an export advocate (political appointee) at the Office of the Secretary of Defense, possibly with a counterpart at each Service, to assist marketing of broader defense capability.
- 3-9 The United States should reduce export approval obstacles. The process for notifying Congress on defense exports should include a statement on the economic consequences of denial.
- 3-10 The United States should streamline the FMS system to improve response time and move it closer to the direct commercial sales process. The export licensing process should be simplified by granting blanket export licenses for unclassified technical data, waiving export licenses if technology is available in the international market, and reducing the State Department Office of Munitions Control (OMC) license turnaround time to 30 days using additional resources if necessary.
- 3-11 The United States should ensure U.S. industry's participation in foreign defense markets in return for foreign industry's entry into the U.S. defense market through reciprocal MOUs.

- 3-12 The U.S. Army should apply reciprocal and equivalent offset demands against our defense trading partners.
- 3-13 The United States should waive R&D recoupment charges on FMS sales and recognize the higher profitability needs of foreign sales to compensate for higher selling costs.
- 3-14 The United States should enhance the technology leadership of U.S. industry by continuing independent R&D funding to industry, increasing incentives for engineering education and careers of U.S. nationals, providing incentives for investment in state-of-the-art manufacturing facilities, and maintaining data rights on internally developed equipment.
- 3-15 DoD should improve communications between its personnel and U.S. industry on international requirements and competitiveness and communicate the importance of internationalization down through the acquisition bureaucracy. It should also improve communications on the importance of globalization.
- 3-16 DoD should restructure domestic procurement policy by streamlining the acquisition process, simplifying design specifications, emphasizing life-cycle costs, and using either competitive procurement or audit-based competition, but not both.
- 3-17 The U.S. Army should establish a permanent working group with U.S. industry to clarify specific recommendations, follow up to ensure implementation of recommendations, communicate progress on a regular basis to all constituencies, and identify and address additional key concerns as they develop.
- 4-1 Multilateral negotiations to reduce offsets should be pursued in the General Agreement on Tariffs and Trade and other forums, but it should be recognized that success in such negotiations will be difficult to attain and take years of negotiation. The United States should not use legislation or regulation to impose unilateral offset controls that would have the effect of transferring defense business to foreign competitors.
- 4-2 Offsets should not be permitted on sales financed by grant aid or forgiven loans for FMS.
- 4-3 When offsets are required by FMS cash customers, the cost of providing the offset should be an allowable cost to the contractors providing the offset.
- 4-4 In negotiating or renewing bilateral reciprocal MOUs, the United States should seek agreements to limit offset demands.
- 4-5 Offsets demanded by reciprocal procurement MOU partners should be limited to direct offsets associated with system-specific codevelopment and coproduction or, if indirect offsets are unavoidable, they should be limited to such business

relationships as joint ventures, technology transfers, investments, and equity sharing that increase rather than reduce international trade.

- 4-6 Industry should have a detailed role in negotiating system-specific MOUs.
- 4-7 The U.S. Army should endeavor to identify and understand the positive effects of reasonable and acceptable offset arrangements and publicize these effects. They include: increasing defense sales to friends and allies; creating jobs in U.S. defense industry; assisting in maintaining the U.S. defense industrial base; enhancing rationalization, standardization, and interoperability and U.S. influence with customer countries; providing sources of technology flowback to improve U.S. defense capabilities; and expanding international trade.
- 5-1 The U.S. Army should pursue flexibility and early establishment of parameters for third-country sales.
- 5-2 The U.S. Army should improve its response times for review of international program actions. Steps should be taken to streamline the system including offering technical assistance to OMC (e.g., pre-screen export license applications).
- 5-3 The United States should resolve the difficulties created by the time allowed to respond to requests for proposals (RFPs) and the time it takes for the system to act on a request to communicate with potential partners. Releasability to other countries should be included in RFPs so that cooperative opportunities can be identified as early as possible in the acquisition process.
- 5-4 When an MOU is being negotiated, the U.S. Army should provide for pre-approval of technology transfer associated with the agreement.
- 5-5 U.S. industry should be allowed to request that the U.S. Government review an exception to National Disclosure Policy (ENDP) and the U.S. Army should enlarge its role in the management of ENDP actions by maintaining current records of the status of such actions.
- 5-6 The Militarily Critical Technologies List, which was developed to provide a basis for controls on West-East trade, should not be applied to trade and technology transfers within the West.
- 5-7 The U.S. Army should recognize that armaments cooperation is a two-way street and that participation in such programs can have positive effects on the U.S. technological and industrial base.
- 5-8 DoD should consider foreign availability when determining technologies to be controlled and conduct cross-Service reviews to ensure that a technology release is not denied by one Service and approved by another.

- 5-9 The U.S. Army should recommend multiyear funding of international cooperative programs to provide greater stability and compatibility with partner nations' budget processes.
- 5-10 The U.S. Army should define its armaments cooperation processes and policies more clearly by stating who is in charge, identifying a champion, providing guidelines, and professionalizing the international acquisition career service.
- 6-1 The U.S. Army should adopt a more positive and active policy toward international armaments cooperation. It should resist the tendency to insert cooperative approaches in the middle of or late in the program life cycle or to regard armaments cooperation as a special interest item. Instead, the U.S. Army should strive to harmonize requirements, solicit foreign government as well as U.S. and foreign industry views early in a program's concept exploration, and improve the mechanisms for communicating between the industrial and military parties among the allied countries.
- 6-2 The U.S. Army and industry must work together to reduce the perceived adversarial quality of the relationship between them, particularly in the international arena. Industry leaders must be convinced of the sincere interest of the U.S. Army and DoD in international armaments cooperation.
- 6-3 The U.S. Army should establish the mechanisms to follow through with the recommendations presented by the industry working groups and maintain a dialogue between U.S. industry and the U.S. Army on these international issues.

APPENDIX B

TERMS OF REFERENCE:

**U.S. INDUSTRY COMMITTEE
FOR ARMY INTERNATIONAL PROGRAMS**

**TERMS OF REFERENCE
U.S. INDUSTRY COMMITTEE FOR ARMY
INTERNATIONAL PROGRAMS**

of the American Defense Preparedness Association

1. MISSION

Provide a forum for developing and sustaining a U.S. Army-U.S. industry dialogue on direct commercial and foreign military sales of defense equipment to foreign governments; the transfer of technology to and from other countries; cooperative research, development, and production that results from such transfers; and associated logistics support and training. Issues to be addressed include:

- U.S. Government support of U.S. industry defense export sales
- Industrial teaming and organization for international cooperative programs
- Preservation of the U.S. industrial base, foreign dependency, and foreign direct investment
- Alliance defense market environment and trade offsets
- U.S. Government technology transfer security policy.

2. ESTABLISHMENT OF COMMITTEES

- a. A committee of senior industry executives is hereby established to address international program issues related to the U.S. Army mission. Its name is the "U.S. Industry Committee for Army International Programs," known informally as the "headquarters committee."

- b. The appropriate ADPA chapters are hereby authorized to establish additional committees to address international program issues related to particular Army materiel or mission areas (e.g., aviation, missiles). The names of such additional committees shall be "U.S. Industry Committee for Army (e.g., Aviation, Missile) International Programs," known informally as the "chapter committee(s)."

3. MEMBERSHIP

- a. **Headquarters Committee.** The headquarters committee shall consist of no more than twelve industry members. Industry participants must be individual or corporate members of ADPA. Industry participants shall be appointed by ADPA on recommendation from the chairman of the ADPA International Affairs Division, who shall also designate the committee chairman.
- b. **Chapter Committee(s).** Chapter committees shall be of such size as may be agreed between ADPA headquarters and the chapter concerned. Membership would be drawn principally from interested local U.S. industry. Industry participants must be members of the ADPA chapter and shall be appointed by the ADPA chapter presidents, who shall also recommend the committee chairmen.

4. TERM OF OFFICE

Industry participation in the headquarters and chapter committees shall be on a rotational basis. Members shall serve for three-year terms, and may be reappointed with the consensus of the committee. At start-up, one-third of the initial industry members of each committee shall rotate off the committee in each year of a three-year cycle. Succeeding members shall serve for three years.

5. MEETINGS

- a. The committees shall determine their own agendas and meet at the call of their chairmen as dictated by the requirements placed upon them. However, the headquarters committee shall meet no less than quarterly.
- b. The committees shall convene an annual conference, the agenda for which shall include reports from the headquarters and chapter committees and

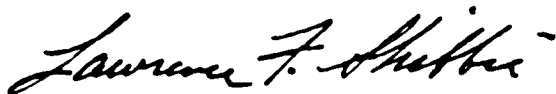
such other items as may be selected for review by the headquarters committee.

- c. Attendance at the annual conferences shall be open to all members of ADPA. Non-committee members may be invited as speakers or panelists.
- d. Special *ad hoc* working groups may be formed under the headquarters and chapter committees to study in greater depth particular subjects proposed by committee members and agreed by the committee. Reports presenting findings, conclusions, and recommendations on these subjects may be prepared and distributed as agreed by the committees.
- e. From time-to-time appropriate officials from U.S Army agencies shall be invited to participate in committee meetings, conferences, or *ad hoc* working groups for the purpose of exchanging views, listening to industry concerns, and providing a U.S. Army perspective on the deliberations. Such participation does not imply official sponsorship of this activity and will occur consistent with applicable laws and Army regulations.

6. LOGISTICS SUPPORT

- a. The ADPA headquarters staff shall provide support for the headquarters committee, including *rapporteur* services during meetings, on the same basis as is provided to other ADPA committees.
- b. The chairmen of the chapter committees shall be responsible for arranging for the logistics support of their own committees.

Approved 21 November, 1989



Lawrence F. Skibbie
Lieutenant General, USA (Ret.)
President, ADPA

APPENDIX C

**ARMY ACQUISITION EXECUTIVE (AAE)
POLICY MEMORANDUM NO. 88-8,
INTERNATIONAL COOPERATION IN RESEARCH, DEVELOPMENT,
TESTING, EVALUATION AND ACQUISITION (RDTE&A)**

8 NOVEMBER 1988



DEPARTMENT OF THE ARMY
OFFICE OF THE UNDER SECRETARY
WASHINGTON, D.C. 20310-0102

8 November 1988

MEMORANDUM FOR SEE DISTRIBUTION

SUBJECT: Army Acquisition Executive (AAE) Policy
Memorandum No. 88-8, International
Cooperation in Research, Development,
Testing, Evaluation and Acquisition
(RDTE&A)

The purpose of this memorandum is to provide guidance on the formation and support of international cooperative RDTE&A ventures.

International cooperation in RDTE&A offers an opportunity to capitalize on advanced technology developed by our allies and to make programs more affordable by spreading costs among a number of partners. Additionally, cooperative RDTE&A provides the Army with a way to avoid R&D expenditures through the testing and acquisition of Non Developmental Items (NDI) produced overseas. Finally, RDTE&A reinforces the burden sharing desires of Congress and the Administration by enjoining our allies to pay for an equitable percentage of their defense.

As a means of encouraging a higher level of international cooperation between the United States and its allies, Congress passed the "Nunn Amendment" to the FY 86 DOD Authorization Act which, for the first time, provided monies specifically for cooperative RDTE&A ventures. This annual infusion of Congressionally approved funding has been followed by Defense Guidance for FY 90-94 which sets a growth objective for international cooperation. By FY 1994 ten percent of the Army's RDT&E resources are to be dedicated to programs in which the US and other nations contribute an equitable portion of the research, development, test and evaluation costs, or a negotiated share of a program based upon agreement of technical work shares. By FY 2000 the figure is scheduled to reach 25 percent.

In order to take maximum advantage of the additional yearly funding provided by Congress, the technology advances and NDI equipment of our allies plus the monies available from potential partners, it is essential to focus on those opportunities that offer the greatest return on investment.

Accordingly, R&D projects selected to become international ventures will be of such importance that they will be pursued as "U. S. only" efforts even if overseas partners can't be attracted. Key parameters for each cooperative R&D project are as follows:

- o Contribute toward improving conventional defense posture.
- o Meet a defined U. S. requirement.
- o Occupy a priority position in the Army's Long Range RDA Plan (LRRDAP).
- o Be suitable for collaboration.
- o Be supported within the Army, OSD and Congress.
- o Be funded in the Five Year Defense Plan or scheduled for funding submission.
- o Be of interest to potential partners who have money and are willing to share project cost on an equal or equitable basis.
- o Be acceptable for either U. S. or overseas lead/management.

Selection of NDI equipment produced by our allies for test and evaluation will be governed by an equally strict set of criteria. Each item must:

- o Satisfy a valid requirement/operational deficiency or provide a legitimate alternative to a U. S. system in the late stages of development or offer a cost, schedule or performance advantage over existing U. S. equipment/systems.
- o Be about to enter service or in service and have a proven track record with one or more of our allies.

- o Be free from U.S. off-shore procurement restrictions.

- o Be supported for testing within the Army user and materiel development community.

- o Have procurement dollars available, or that can be made available, for acquisition if the evaluation is positive.

Based on the proceeding I ask that the following be accomplished:

- o The ASARC Secretary is to ensure that international cooperative opportunities are presented by the PEO's as an explicit agenda item at all major milestone reviews.

- o PEOs/PMs are to prepare the International Armaments Cooperative Opportunities Plan (IACOP) in accordance with Section 1103 of P.L. 99-145 (the Nunn Amendment). The objective is to comply with the statute and have an honest assessment of the international cooperation feasible for their programs as early as possible in the development process.

- o PEOs/PMs are to ensure that acquisition strategies include market surveys to identify overseas NDI opportunities. The objective is to maximize the utilization of the NATO Cooperative Test and the Foreign Weapons Evaluation Programs for the NDI candidates with the most potential.

- o AMC and TRADOC are to ensure that international cooperative opportunities are included as an integral part of the LRRDAP and Mission Area Master Plan (MAMP) building, review, and decision process and provide an assessment of the possibility for cooperative ventures. The objective is to avoid duplication and gain greater utilization of technology being developed by our allies.

- o TRADOC should consider our international commitments and opportunities as a factor in the prioritization process as programs compete for funds. Programs with marginal priority should not be selected for international cooperation. The objective is to avoid unfunded international commitments.

The Assistant Secretary of the Army (Research, Development and Acquisition) is responsible for international programs within the Secretariat. These programs need to be clearly identified to ensure visibility during all the budget/POM hearings/forums so we do not inadvertently abrogate our international commitments.

International cooperation in RDTE&A is an emerging trend. While certain critical risk technology programs may not be desirable for international cooperation, there are numerous programs which represent excellent candidates for international ventures. These need to be searched out and taken advantage of in order to enhance technology, to achieve standardization, and leverage our decreasing RDTE&A funding for a greater return on our investment.

M. P. W. Stone

Michael P. W. Stone
Army Acquisition Executive

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COMMANDANT, U.S. ARMY ENGINEER SCHOOL

ALL PROGRAM EXECUTIVE OFFICERS

APPENDIX D
MUNITIONS LICENSE STATUS POINTS OF CONTACT

USASAC

Office for International Industrial Cooperation (AMSAC-MI)
U.S. Army Security Assistance Command (USASAC)
U.S. Army Materiel Command
5001 Eisenhower Avenue
Alexandria, VA 22333-0001
Telephone: (703) 274-9177
Facsimile: (703) 274-3826

DTSA

License Directorate
Defense Technology Security Administration (DTSA)
U.S. Department of Defense
400 Army Navy Drive
Arlington, VA 22202
Telephone: (703) 697-5336
ELISA FAX: (703) 697-2383
ELISA: (703) 697-6109
Export License Status Advisor (ELISA) can be reached 24 hours/day using a standard computer workstation and a modem rate of 300/1200/2400 baud (no parity).

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Automated License Status System (ALISS) can be reached 24 hours/day, except between 0700 and 0900, when it is updated.